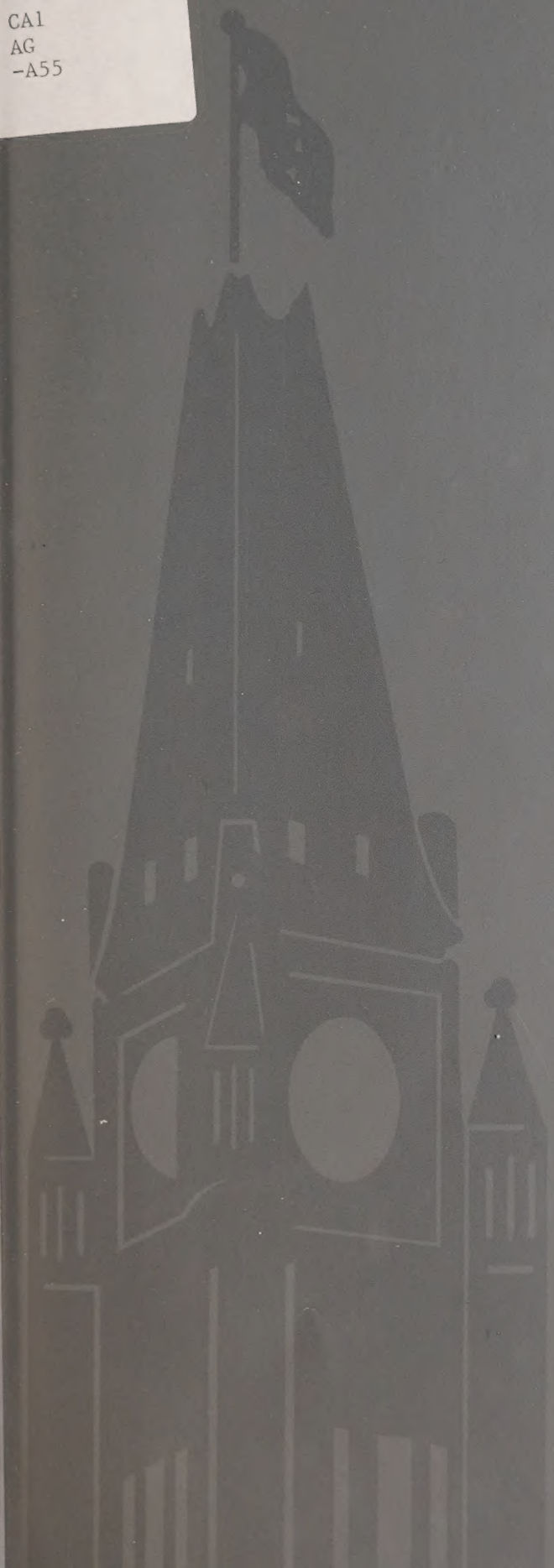
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# Report of the Auditor General of Canada to the House of Commons

## Foreword and Main Points



**September 1998**

# Report of the Auditor General of Canada to the House of Commons

## Foreword and Main Points




# September 1998

*This September 1998 Report comprises 9 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.*

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AUDITOR GENERAL OF CANADA

VÉRIFICATEUR GÉNÉRAL DU CANADA

To The Honourable the Speaker of the House of Commons:

I have the honour to transmit herewith my second Report of 1998 to the House of Commons, to be laid before the House in accordance with the provisions of section 7(5) of the *Auditor General Act*.

L. Denis Desautels, FCA
Auditor General of Canada

OTTAWA, 29 September 1998


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# September 1998

## Foreword and Main Points

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# Report of the Auditor General to the House of Commons for September 1998

## Foreword

I am pleased to present the September volume of my 1998 Report. Bound with this Foreword are the Main Points of nine chapters, which are issued separately:

10. Canadian Human Rights Commission – Human Rights Tribunal Panel

11. Agriculture and Agri-Food Canada – Cash Advance Program

12. Creation of the Canadian Food Inspection Agency

13. National Energy Board

14. Indian and Northern Affairs Canada – Comprehensive Land Claims

15. Promoting Integrity in Revenue Canada

16. Management of the Social Insurance Number

17. Patented Medicine Prices Review Board

18. The Financial Information Strategy: A Key Ingredient in Getting Government Right

With this Report, I continue to develop several of the issues raised in my 1997 Matters of Special Importance: moving the focus from inputs and process toward results; maintaining accountability as activities move outside of traditional government structures; promoting integrity within government; and making comptrollership a reality.

Shifting the focus toward results is fundamental to increasing the effectiveness of day–to–day government operations. In an environment where the nature of organizations is changing and programs face competing objectives, it is essential that managers set specific goals for program performance, measure and report on progress, and use that information to ensure that the government can meet its objectives. Effectiveness tools such as evaluations have a key role to play by providing decision makers with information on how well policies and programs are working and how they can be improved.

Another matter I raise in this Report is the government's shift from traditional ways to new methods of delivering some services and programs to Canadians. Some of the changes allow for greater flexibility in managing resources, particularly human resources. However, accountability for the results is still essential. This will require a common understanding of roles and responsibilities, clearly stated objectives and expectations, and full and frank reporting on performance. The challenge will be to incorporate flexibility and accountability together without reverting to traditional ways of doing business.

Laying a strong ethical foundation for the promotion of integrity within government is another issue I examine in this Report. The government needs to promote a framework that focusses on principles, leadership, empowerment of public servants to act in the public interest, training, and mechanisms for reporting concerns. There is still a need to be vigilant in promoting ethical conduct in government.

## Foreword (cont'd)

Last, I look at improvements the government is making in its financial management capabilities, and the structure it is creating to allow decision makers to assess the financial consequences of their decisions.

Success in all of these areas depends on the visible commitment of management at the highest levels. Managers will need to marshal support throughout the organization, following best practices and lessons learned from the experience of others and integrating them into day–to–day decision making.



# Canadian Human Rights Commission

# Human Rights Tribunal Panel

## Chapter 10 – Main Points

**10.1** In 1977 Parliament established the Canadian Human Rights Commission and the Human Rights Tribunal Panel to resolve human rights complaints quickly, impartially and expertly. The Commission investigates complaints and, if it decides that an inquiry is warranted, forwards the complaint to the Tribunal for adjudication. This model was chosen as the alternative to the formal processes of the courts. However, the approach that has evolved is cumbersome, time-consuming and expensive.

**10.2** Between 1988 and 1997, the Commission received about 7,450 signed complaints, excluding pay equity complaints. It made final decisions on about 6,550 of the 7,450 signed complaints. The Commission dismissed or did not proceed with about two thirds of these complaints. About six percent of complaints were forwarded to the Tribunal for inquiry.

**10.3** Although major efforts have been made to improve the handling of complaints, it still takes a long time for a complaint to be reviewed — an average of about two years for the Commission and about a year for the Tribunal. In 1997 almost one half of the Commission's 900 open cases were still being investigated one year after the signing of the complaint.

**10.4** The Commission tries to settle complaints through conciliation and the Tribunal also tries to mediate complaints after the Commission forwards them for inquiry. Because the Commission has its own settlement objectives, it is not a neutral conciliator. Since 1996 about 18 percent of complaints have been settled through early resolution or conciliation. The Commission took an average of about 45 months to reach a final decision when complaints were investigated and then sent to conciliation.

**10.5** The Commission and the Tribunal are operating in a complex environment that poses major risks. The grounds for making a complaint are increasing and concepts of discrimination are becoming more complex. The environment also is more litigious and contentious. The Commission's total funding has been reduced from a high of $16.15 million in 1992–93 to $14.8 million in 1998–99. The number of investigators also has been reduced from a high of 37 to 25. Further, the Commission is experiencing a high turnover of investigative staff, necessitating the reassignment of cases to other investigators. We also are concerned that the Commission is not consistently adhering to some of its key investigative standards.

**10.6** We note that the Minister of Justice has stated that a broad review of the *Canadian Human Rights Act* will be undertaken. The Commission has welcomed this proposal. The December 1997 Third Report of the Senate Standing Committee on Legal and Constitutional Affairs also called for a comprehensive assessment.

**10.7** We agree that a fundamental review by Parliament is needed and recommend that the government identify and present to Parliament an integrated set of specific measures to increase the effectiveness of addressing human rights complaints. Possible measures are summarized in the concluding section of this chapter.

# Agriculture and Agri-Food Canada

## Cash Advance Program

## Chapter 11 – Main Points

**11.1** The Department's cash advance program is one vehicle the government makes available to producers of storable crops to provide additional flexibility in making marketing decisions. It consists of a short-term loan made available at harvest, a time when financial obligations of producers are often at their peak. The financing provides a bridge for producers until they market their crop and begin to earn revenue. In recent years, the annual amount of these loans has ranged from $730 million to over $1.2 billion.

**11.2** The program has been very well received. Producers we contacted liked the availability and predictability of cash flow at harvest time, and the interest-free feature of the program. Many of the large agricultural assistance programs of the past have ended, and producers see this program as an important sign of continuing government support for the sector.

**11.3** In 1993, the Department's Review Branch completed an evaluation that reached some positive conclusions about the program, but also raised some significant concerns, particularly with the program's interest-free nature. It also concluded that there was no firm evidence that the program contributes to orderly marketing.

**11.4** In 1997 new legislation, the *Agricultural Marketing Programs Act (AMPA)*, was passed that updated and consolidated the two previous cash advance programs into one, and made permanent in legislation the interest-free provision. The rationale for providing advances interest-free was not made clear by the government, despite the evaluation's finding that a clear objective for this component was needed.

**11.5** Under the new legislation, a review of the provisions and operations of the Act must be completed in the fifth year of operation, which begins in 2001. The 1993 evaluation furnished important information about the program's effectiveness; however, as in any study, some questions remain unanswered that we believe should be addressed in the coming review. Among others, these include whether producers indeed face a significant problem of access to credit at harvest time and whether losses arising from the government's guarantee on these loans are being well managed.

**11.6** We identified limitations in how the cash advance evaluation findings were publicly reported. Similar limitations were noted in the dissemination of other studies produced by departmental branches on the impacts and effectiveness of programs. In our view, a number of characteristics of the Department, its legislation and stakeholder community create a strong case for more actively alerting outside parties to the existence and findings of effectiveness studies. Some areas of the Department are indeed taking steps in this direction.

# Creation of the Canadian Food Inspection Agency

## Chapter 12 – Main Points

**12.1** The federal government is considering the use of alternative service delivery (ASD) arrangements in order to improve service delivery. The Canadian Food Inspection Agency (CFIA) was the government's first legislated service agency; it was created as a departmental corporation and became operational 1 April 1997. Its primary responsibility is to contribute to food safety, plant and animal health as well as to facilitate trade in all areas by providing inspection and related services.

**12.2** There was a clear rationale for creating the Agency, including a 30-year history of studies related to reorganizing the federal food inspection system and the government's commitment to a new and better way of delivering services. Senior officials of the three federal departments then involved in food safety inspection supported the initiative to create a single food inspection service. This initiative illustrated that change can be best introduced and sustained when there is a clear rationale that has the support of senior officials.

**12.3** The designation of a structured and independent team was crucial to managing the move to agency status. The team's work was separate from the ongoing business of inspections and quarantine activities, so those services could continue without interruption throughout the creation of the CFIA.

**12.4** One of the driving forces behind the move to ASD arrangements is their greater flexibility in human resource management. With the move outside the *Public Service Employment Act* and the change to separate employer status, the shift to a new human resources regime was one of the Agency's greatest challenges. The complexities entailed in creating a new human resource framework as a separate employer need to be recognized and planned for early in the change process.

**12.5** In an area of shared responsibility such as food safety, roles need to be carefully defined and mechanisms established to resolve unanticipated problems. The establishment of an accountability framework was a key concern during the creation of the CFIA. Specific responsibilities for food safety were assigned to the Minister of Agriculture and the Minister of Health. Some operational details were still being worked out as new issues arose during the first year of operations.



# National Energy Board

## Chapter 13 – Main Points

**13.1** The *National Energy Board Act* has not been amended significantly since it established the National Energy Board (NEB) in 1959. While the NEB has been given some new responsibilities in areas such as frontier activities, its role has not changed much since its creation. However, its modus operandi has changed significantly. Through regulatory changes, the Board has moved from an interventionist approach to reliance on market-based forces, industry self-regulation and negotiated toll structures. During this period of evolution, the NEB has moved its operations from Ottawa to Calgary, downsized its staff complement by 35 percent and reorganized itself internally for greater efficiency. However, it has not objectively measured the extent to which it is being effective and relevant.

**13.2** The Board has recognized that the aging of the Canadian pipeline system poses potential threats to public safety and the environment. The number of reported pipeline incidents has increased in recent years. A risk assessment methodology is being developed that should improve the targeting of inspections and safety audits. However, deficiencies in information management will need to be addressed.

**13.3** The Board's ability to fully meet its environmental regulatory responsibilities is at risk due to shortfalls in its environmental inspection program — namely, in setting priorities and scheduling inspections and in inspection practices, which are too informal and unstructured.

**13.4** Since 1991, the NEB has recovered most of its costs from industry. No change has yet been made to its cost allocation method, despite some concerns expressed by stakeholders about its fairness. The NEB has settled for simplicity at the expense of cost causality. The Board does not have a cost accounting system; it needs to recover costs in a way that is more equitable and acceptable to stakeholders.

**13.5** The NEB is moving toward management for results, by adopting a new accountability framework and changing its style of decision making. While it is too early to evaluate the results of this initiative, we noted that significant opportunities exist to better link its human resource management activities to its vision of the future. In addition, the NEB will need to state and report clearly what it wants to achieve, monitor its performance on a regular and systematic basis and better link the results achieved to the costs.



# Indian and Northern Affairs Canada

## Comprehensive Land Claims

## Chapter 14 – Main Points

**14.1** Comprehensive land claim settlements are modern treaties that are significant not only to Aboriginal communities but also to all Canadians. Settlements involve the payment by the federal government to Aboriginal groups of almost two billion dollars and the clarification of various rights, including full ownership of over a half-million square kilometres of land. The first modern negotiated settlement of a comprehensive land claim was signed in 1975, and the most recent settlement was reached in July 1997. As of July 1997, 12 claims had been settled. Actual and potential claims involving over 200 First Nations are still to be settled.

**14.2** The Government of Canada has chosen to settle these claims by negotiation rather than litigation or other means. Indian and Northern Affairs Canada is the lead federal representative in negotiations, with participation of other federal departments as appropriate. Other parties include the territorial governments, provincial governments, and the claimants. Although the Department bears significant accountability for results, it is not the only party that should be accountable; the good will and political resolve of all participants are needed in order to achieve appropriate settlements.

**14.3** The government has reported that negotiated settlements establish certainty to land title and access to land and resources. However, removing uncertainty involves much more than signing an agreement. Among other things, successful implementation of settlements is critical to achieving the intent of these treaties. Implementation involves hundreds of projects with joint or separate participation of the parties. We found deficiencies in implementation, including inadequate or non-existent implementation plans, and the need to improve monitoring, reporting and evaluating.

**14.4** Indian and Northern Affairs Canada has not demonstrated that it has always exercised adequate rigour in determining the nature and amount of assets that may ultimately be included in final settlements, including such considerations as the amounts of cash, land and other resources.

**14.5** Settlements can take over 20 years to reach. Delays have had many causes. In our view, these long time frames do not contribute to cost effectiveness, and may result in less desirable outcomes for all concerned.

# Promoting Integrity in Revenue Canada

## Chapter 15 – Main Points

**15.1** The success of Revenue Canada's programs depends largely upon voluntary compliance with tax requirements by individuals and businesses. We believe that one of the many factors affecting the likelihood of their voluntary compliance is their perception of the conduct of Revenue Canada's staff. An organization like Revenue Canada, with its decentralized operations and the extensive exercise of judgment by employees, must take adequate precautions to minimize the risk of employee misconduct. Our audit looked at various means that the Department employs to promote integrity among its employees.

**15.2** All of these means, taken together, form an important foundation for the promotion of integrity in Revenue Canada. The Department investigates incidents of misconduct; discipline is imposed on employees found guilty of misconduct; and, on the whole, management takes appropriate action, where weaknesses are highlighted by incidents, to prevent similar misconduct. Further, distributing statements of its mission, vision and values and three key booklets on conduct are important steps Revenue Canada has taken toward promoting an ethical culture. Most employees have received some formal training on expected conduct.

**15.3** There are areas where improvement will help Revenue Canada reinforce this sound foundation. Because the disciplinary process can be slow, its effectiveness as a deterrent to similar misconduct may be diminished. While management takes action to correct weaknesses highlighted by incidents, at times its responses are slow and focussed narrowly on local rather than department-wide weaknesses. Further, information provided on values and conduct is not presented in a way that allows easy understanding, and training is uneven. The Department takes few steps to monitor the level of employees' understanding of expected values and conduct. Nor does it provide an individual whom employees can consult on a confidential basis on issues of integrity.

# Management of the Social Insurance Number

## Chapter 16 – Main Points

**16.1** The Social Insurance Number (SIN) was implemented in 1964, to provide Unemployment Insurance, Canada Pension Plan and Quebec Pension Plan clients with a file number. In 1967, it also became a file identifier for Revenue Canada. From the outset, the SIN was the subject of intense parliamentary interest and debate. The controversy focussed largely on the implications of a potential expansion of its use to become a universal identifier. The history of the SIN has mainly reflected the tension between balancing the often competing objectives of maintaining individual privacy and improving administrative efficiency and effectiveness.

**16.2** Human Resources Development Canada has been administering the SIN in accordance with the intent of its legal framework whereby the SIN is intended to be a file identifier (account number) for certain federal government programs. However, the public often perceives the SIN to be a personal identifier or even an identity card.

**16.3** The use of the SIN outside the federal domain has evolved beyond the intent of the Treasury Board policy established in 1989, aimed at preventing it from becoming a national personal identifier. Our audit found that the SIN has become the common numerical identifier both inside and outside the federal government for a wide range of income-related transactions and benefits, among other uses.

**16.4** Changes to the *Income Tax Act* and Regulations have increased the use of the SIN at the provincial/territorial level and in the private sector, as have the growing number of data exchanges, comparisons and matches among various tiers of social programs.

**16.5** However, the SIN has a number of weaknesses. Some of them are well known. As the use of the SIN has become more widespread, these weaknesses have grown in importance. They include the following:

- The information on SIN holders, particularly on births and deaths, is not always complete and accurate.
- Existing SIN application procedures are insufficient to guard against fraud and abuse. Holders of 11.8 million SINs who registered prior to the introduction of the proof-of-identity program in 1976 have not been asked to provide proof-of-identity documentation. This exacerbates the risk of misrepresentation.
- The provinces and financial institutions are required by the *Income Tax Act* and Regulations to collect SINs for tax purposes but cannot validate the SIN numbers provided by their clients.
- SIN errors, abuse, and misuse affect many federal programs, provinces and the private sector. Collectively, the impact may be sizable.
- Minimal effort is dedicated to investigations of SIN fraud and abuse, and penalties are minimal, with no real impact on deterrence.
- Unregulated use in the private sector, except in Quebec, makes it vulnerable to abuse in terms of both privacy and fraud.

**16.6** The effectiveness of certain administrative decisions as well as the integrity of social programs are greatly facilitated by the reliability of the information contained in the SIN data base. We believe it is time to review the current roles, objectives and uses of the SIN in light of its governmental and societal importance. The government needs to clearly state the level of integrity and privacy protection expected in the system.

**16.7** There appear to be two options: improve the existing framework to catch up with the current reality of SIN usage or else devise an acceptable alternative solution to meet the needs of users, including governments and individuals. In any case, the privacy implications need to be recognized. In our view, it is essential that Parliament play a major role in debating these issues, increasing public awareness, and finding a satisfactory solution.

# Patented Medicine Prices Review Board

## Chapter 17 – Main Points

**17.1** The Patented Medicine Prices Review Board (PMPRB) is a small quasi-judicial board with an annual budget of approximately $3 million and 35 full-time-equivalent employees. Created in 1987, it has a mandate to protect consumer interests and contribute to Canadian health care by ensuring that prices charged by manufacturers of patented medicines are not excessive. However, the scope of its jurisdiction and the limitations of its consumer protection role are not widely understood.

**17.2** Since 1988, average annual increases in prices of patented medicines have moderated. The Board has contributed to the containment of patented drug prices, and has taken steps to assess the impact of federal price regulation. However, other factors also have contributed and we are concerned that the Board's estimates of its savings to the Canadian health care system are overstated. In reporting its results to Parliament, the Board did not clearly identify the limitations of the estimates of its own impact.

**17.3** The audit identified issues pertaining to the legislative framework that need to be reviewed. The legislation is silent or unclear on certain areas. In addition, some requirements under the legislation are difficult to apply in practice, and consideration needs to be given to reviewing their continued relevance.

**17.4** The majority of patented drugs sold in Canada are priced within the Board's guidelines. However, the Board needs to ensure that its price review decisions are clear and transparent. The Board also needs to identify cost-effective means to check the accuracy of price information submitted by manufacturers. Improvements are also required in the reporting of drug price trends and pharmaceutical research and development expenditures.

# The Financial Information Strategy: A Key Ingredient in Getting Government Right

## Chapter 18 – Main Points

**18.1** Under the Financial Information Strategy (FIS), the government is making sweeping changes in the type of financial information provided to decision makers. FIS involves the move to full accrual accounting similar to that used by business firms, the implementation of new financial systems and the integration of full accrual financial information into day-to-day decision making of departmental managers. When fully implemented, by 2001 according to the current plan, FIS should help the government strengthen significantly its management of business lines and its accountability to Parliament. The government has clearly indicated that it is committed to *getting government right* and has established FIS as one important initiative in doing this. The Office of the Auditor General fully supports the stated objectives of FIS.

**18.2** FIS began a decade ago. Progress in the early years was slow, but in recent years the tempo of work has picked up. To date, FIS has focussed on implementing new departmental financial systems that are Year 2000-compliant and on ensuring that departmental and central systems will provide appropriate information to include in the government's annual financial statements.

**18.3** However, the government has yet to implement its plans to deal with the important area of making full accrual financial information available to officials within departments and agencies who manage business lines and related components on a day-to-day basis. One of the objectives of FIS is to provide officials with more complete information on costs to compare with results achieved when making key decisions. Until this is done, the full benefits of FIS will not be realized.

**18.4** While better cost information for decision making is a benefit of FIS, we note that neither individual departments nor the government overall are aware of the full costs of FIS implementation, which could be significant.

**18.5** The government and Parliament can help ensure the success of FIS by appropriating funds on a full accrual basis, so that accountability and reporting are on the same basis. But central agencies and individual departments must also act to help ensure that the full benefits of FIS are achieved. Central agencies must secure complete departmental "buy-in", and deputy ministers of individual departments must put in place the necessary infrastructure, including appropriate systems and human resources.

**18.6** Departments face a major challenge in completing the renewal of their financial systems to meet the objectives of FIS. Best practices and lessons learned from others who have gone before can help achieve success.

**18.7** Given the massive scale of financial systems renewal now under way to meet the Year 2000 challenge, we believe that there is a unique opportunity to put FIS in place by the 2001 target implementation date. This is not a simple task. To obtain the full benefits of FIS and thus have in place the information required for government today, the challenges faced by the government and summarized in this chapter must be met. In future audits, we will continue to track the government's progress in implementing FIS and achieving these benefits.

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**18.7** Étant donné l'ampleur du renouvellement des systèmes financiers qui se déroule en vue de relever le défi de l'an 2000, nous sommes d'avis qu'il s'agit d'une occasion unique de mettre en place la SIF d'ici la date cible de mise en oeuvre, soit l'an 2001. La tâche n'est pas facile. Les défis qui se posent au gouvernement et qui sont résumés dans le présent chapitre doivent être relevés afin que tous les avantages de la SIF puissent se concrétiser et que le gouvernement puisse disposer de l'information dont il a besoin. Dans le cadre des vérifications qui auront lieu ultérieurement, nous continuerons de mesurer les progrès accomplis par le gouvernement pour la mise en oeuvre de la SIF et la réalisation de ses avantages.

# La Stratégie d'information financière : un outil essentiel pour repenser le rôle de l'État

## Chapitre 18 – Points saillants

**18.1** Au moyen de la Stratégie d'information financière (SIF), le gouvernement apporte des changements radicaux au type de renseignements financiers fournis aux décideurs. La SIF consiste, entre autres choses, à adopter la comptabilité d'exercice pour toutes les opérations (ou comptabilité d'exercice intégrale), comme c'est le cas dans le secteur des entreprises commerciales, à mettre en oeuvre de nouveaux systèmes financiers et à intégrer l'information financière établie selon la comptabilité d'exercice intégrale dans la prise de décisions quotidienne des gestionnaires ministériels. Lorsqu'elle sera pleinement mise en oeuvre, d'ici 2001 selon le plan en vigueur, la SIF devrait aider le gouvernement à améliorer considérablement sa gestion des secteurs d'activité et sa reddition de comptes au Parlement. Le gouvernement a clairement indiqué qu'il avait pris l'engagement de *repenser le rôle de l'État*, et il a conçu la SIF comme une importante initiative pour y parvenir. Le Bureau du vérificateur général du Canada appuie sans réserve les objectifs énoncés pour la SIF.

**18.2** La SIF remonte à dix ans. Au cours des premières années, son évolution a été lente mais, dernièrement, la cadence des travaux s'est accélérée. Jusqu'à maintenant, la SIF a consisté essentiellement à mettre en oeuvre de nouveaux systèmes financiers ministériels, qui sont adaptés à l'an 2000, et à s'assurer que les systèmes ministériels et centraux produiront une information pertinente destinée à figurer dans les états financiers annuels du gouvernement.

**18.3** Toutefois, le gouvernement doit encore mettre en oeuvre ses plans pour s'attaquer à la tâche importante qui consiste à fournir une information financière selon la comptabilité d'exercice intégrale aux fonctionnaires des ministères et des organismes qui gèrent les secteurs d'activité et les composantes connexes, sur une base quotidienne. L'un des objectifs de la SIF consiste à fournir aux fonctionnaires une information plus complète sur les coûts, à des fins de comparaison avec les résultats obtenus, dans le cadre de la prise de décisions importantes. Tant que cet objectif ne sera pas atteint, tous les avantages de la SIF ne seront pas réalisés.

**18.4** La SIF offre l'avantage d'améliorer l'information relative aux coûts aux fins de la prise de décisions, mais nous constatons que ni les différents ministères ni le gouvernement dans son ensemble ne connaissent les coûts totaux de la mise en oeuvre de la SIF, qui pourraient être élevés.

**18.5** Le gouvernement et le Parlement peuvent contribuer au succès de la SIF en octroyant des fonds selon la comptabilité d'exercice intégrale, de manière à ce que la reddition de comptes et la présentation de rapports s'effectuent également suivant la même méthode comptable. Mais les organismes centraux et les différents ministères doivent également faire leur part pour que tous les avantages de la SIF se concrétisent. Les organismes centraux doivent obtenir « l'appui » sans réserve des ministères, et les sous-ministres de chacun des ministères doivent mettre en place l'infrastructure qui s'impose, notamment les systèmes et les ressources humaines.

**18.6** Les ministères font face à un défi de taille, dans le contexte du renouvellement de leurs systèmes financiers, s'ils veulent atteindre les objectifs de la SIF. Les meilleures pratiques recensées et les leçons apprises par ceux qui ont amorcé leurs travaux plus tôt peuvent contribuer au succès de la mise en oeuvre.



# Conseil d'examen du prix des médicaments brevetés

## Chapitre 17 – Points saillants

**17.1** Le Conseil d'examen du prix des médicaments brevetés (CEPMB) est un petit organisme quasi judiciaire disposant d'un budget annuel de trois millions de dollars environ et d'un personnel de 35 équivalents temps plein. Créé en 1987, il a pour mandat de protéger les intérêts des consommateurs et de contribuer au système de santé canadien en s'assurant que les prix demandés par les fabricants de médicaments brevetés ne sont pas excessifs. Cependant, l'étendue de son autorité et les limites de son rôle de protecteur des consommateurs sont peu connues du public.

**17.2** Depuis 1988, les augmentations annuelles moyennes des prix des médicaments brevetés ont ralenti. Le Conseil a joué un rôle à cet égard et il a adopté des mesures pour évaluer les répercussions de la réglementation fédérale des prix. Cependant, d'autres facteurs ont également contribué à ce ralentissement. Nous craignons que le Conseil n'ait surestimé les économies qu'il a fait réaliser au système de santé canadien. Dans les résultats communiqués au Parlement, le Conseil n'a pas précisé les limites des estimations de sa propre influence.

**17.3** La vérification a permis de cerner des aspects du cadre législatif qui ont besoin d'être examinés. La loi passe certaines questions sous silence ou n'est pas claire à leur sujet. En outre, certaines exigences de la loi sont difficiles à appliquer en pratique. Il faut envisager de les examiner pour déterminer si elles sont encore pertinentes.

**17.4** Les prix de la plupart des médicaments brevetés qui sont vendus au Canada respectent les lignes directrices du Conseil. Cependant, celui–ci doit s'assurer que ses décisions découlant de l'examen des prix sont claires et transparentes. Il doit aussi déterminer des moyens rentables de vérifier l'exactitude des renseignements sur les prix que lui fournissent les fabricants. Des améliorations doivent aussi être apportées aux rapports sur les tendances des prix des médicaments ainsi que sur les dépenses de recherche et développement dans le domaine pharmaceutique.

- On ne consacre que peu d'efforts aux enquêtes sur la fraude et les abus concernant le NAS et les peines sont minimes et n'ont pas d'effets dissuasifs réels.
- L'utilisation du NAS n'est pas réglementée dans le secteur privé, sauf au Québec. Ce numéro peut donc servir à enfreindre la protection des renseignements personnels et à usurper l'identité.

**16.6** L'efficacité de certaines décisions administratives et l'intégrité des programmes sociaux sont grandement facilitées par la fiabilité des renseignements que contient la base de données du NAS. Nous croyons que le moment est venu d'examiner les rôles, les objectifs et l'utilisation actuels du NAS, à la lumière de son importance pour le gouvernement et la société. Le gouvernement doit établir clairement le niveau d'intégrité et de protection des renseignements personnels à attendre du système.

**16.7** Il semble y avoir deux options possibles : améliorer le cadre existant, de façon à tenir compte de l'utilisation actuelle du NAS ou, autrement, concevoir une solution de rechange acceptable pour répondre aux besoins des utilisateurs, y compris ceux des gouvernements et des particuliers. Dans un cas comme dans l'autre, les répercussions du NAS sur la protection des renseignements personnels doivent être reconnues. À notre avis, il est essentiel que le Parlement joue un rôle important dans la discussion de ces questions, dans l'accroissement de la sensibilisation du public et dans la recherche d'une solution satisfaisante.

## Chapitre 16 – Points saillants

**16.1** Le numéro d'assurance sociale (NAS) a été adopté en 1964, comme moyen de fournir un numéro de dossier aux clients de l'assurance-chômage, du Régime de pensions du Canada et du Régime de rentes du Québec. En 1967, il est aussi devenu un code d'identification de dossier pour Revenu Canada. Dès le départ, le NAS a fait l'objet d'un intérêt et d'un débat intenses au Parlement. La controverse portait en grande partie sur les répercussions d'une expansion possible de son utilisation qui en ferait un code d'identification universel. L'histoire du NAS a surtout traduit la tension pour atteindre un équilibre entre les objectifs souvent contradictoires de la protection des renseignements personnels et de l'amélioration de l'efficience et de l'efficacité administratives.

**16.2** Développement des ressources humaines Canada administre le NAS dans l'esprit du cadre juridique selon lequel le NAS devait être un code d'identification de dossier (numéro de compte) pour certains programmes du gouvernement fédéral. Cependant, le public perçoit souvent le NAS comme un code d'identification personnel ou même une carte d'identité.

**16.3** L'utilisation du NAS hors du domaine fédéral a dépassé l'esprit de la politique du Conseil du Trésor établie en 1989, laquelle visait à empêcher ce numéro de devenir un code d'identification personnel national. Au cours de notre vérification, nous avons constaté que le NAS est devenu un code d'identification numérique commun, tant à l'intérieur qu'à l'extérieur du gouvernement fédéral, pour un large éventail de prestations et de transactions relatives au revenu, entre autres utilisations.

**16.4** Les modifications apportées à la *Loi de l'impôt sur le revenu* et au *Règlement de l'impôt sur le revenu* ont encouragé l'utilisation du NAS par les provinces, les territoires et le secteur privé, tout comme l'a fait le nombre croissant d'échanges, de comparaisons et de couplages de données entre les différents paliers des programmes sociaux.

**16.5** Cependant, le NAS comporte un certain nombre de lacunes, dont certaines sont bien connues. Avec l'utilisation accrue du NAS, ces lacunes sont devenues plus importantes.

- Les renseignements sur les titulaires de NAS, en particulier sur les naissances et les décès, ne sont pas toujours complets ni exacts.
- Les procédures existantes de demande de NAS ne suffisent pas à assurer la protection contre la fraude et les abus. On n'a pas demandé aux titulaires de 11,8 millions de NAS qui se sont inscrits avant la mise en place du programme de preuve d'identité, en 1976, de fournir des documents attestant leur identité. Cela accroît le risque de fausses représentations.
- Les provinces et les institutions financières sont obligées, en vertu de la *Loi de l'impôt sur le revenu* et du *Règlement de l'impôt sur le revenu,* d'obtenir les NAS à des fins d'impôt, mais elles ne peuvent pas vérifier les numéros d'assurance sociale fournis par leurs clients.
- Les erreurs portant sur le NAS, les abus et la mauvaise utilisation touchent de nombreux programmes fédéraux, les provinces et le secteur privé. Dans l'ensemble, les répercussions pourraient être considérables.

# Revenu Canada

## Promouvoir l'intégrité au sein du Ministère

## Chapitre 15 – Points saillants

**15.1** La réussite des programmes de Revenu Canada dépend en grande partie de l'observation volontaire de la loi par les particuliers et les entreprises. Nous croyons que la façon dont les clients perçoivent la conduite des employés de Revenu Canada constitue l'un des nombreux facteurs qui influent sur cette observation volontaire. Une organisation comme Revenu Canada, avec ses opérations décentralisées et le rôle considérable qu'y joue le jugement de ses employés, doit prendre des précautions propres à réduire au minimum le risque d'inconduite de son personnel. Notre vérification a porté sur les différents moyens pris par le Ministère afin de promouvoir l'intégrité chez ses employés.

**15.2** Ensemble, tous ces moyens constituent un important fondement pour la promotion de l'intégrité à Revenu Canada. Le Ministère enquête sur les cas d'inconduite; les employés dont l'inconduite est dûment constatée subissent des mesures disciplinaires; et, dans l'ensemble, lorsque des incidents font ressortir des lacunes, la direction prend des mesures appropriées pour prévenir les cas d'inconduite semblables. De plus, en distribuant des énoncés de sa mission, de sa vision et de ses valeurs ainsi que trois brochures clés sur la conduite du personnel, Revenu Canada déploie d'importants efforts pour promouvoir une culture d'intégrité. La plupart des employés ont reçu une certaine formation officielle concernant la conduite qu'on attend d'eux.

**15.3** Il y a des secteurs où des améliorations aideraient Revenu Canada à renforcer ce fondement solide. Parce que la procédure relative aux mesures disciplinaires est parfois lente, son effet de dissuasion contre des inconduites semblables s'en trouve peut-être affaibli. La direction prend des mesures pour combler les lacunes révélées par des incidents mais, parfois, les mesures prises sont lentes à venir et visent des lacunes essentiellement locales plutôt que des situations à corriger dans l'ensemble du Ministère. De surcroît, l'information donnée au sujet des valeurs et de la conduite professionnelle n'est pas présentée d'une manière qui permettrait de l'assimiler aisément, et la formation dans le domaine est inégale. Le Ministère prend peu de mesures pour vérifier jusqu'à quel point ses employés comprennent ses attentes en matière de conduite et de valeurs. Il n'a pas non plus désigné une personne que les employés pourraient consulter en toute confidentialité au sujet de questions d'intégrité.

# Affaires indiennes et du Nord Canada

## Les revendications territoriales globales

## Chapitre 14 – Points saillants

**14.1** Les règlements de revendications territoriales globales sont des traités modernes qui sont importants non seulement pour les collectivités autochtones, mais aussi pour tous les Canadiens. Les règlements territoriaux comportent le paiement de près de deux milliards de dollars par le gouvernement fédéral à des groupes autochtones ainsi que la clarification de divers droits, dont le droit de propriété exclusive de terres d'une superficie totale de plus d'un demi-million de kilomètres carrés. La première entente négociée de l'ère moderne en règlement d'une revendication territoriale globale a été conclue en 1975 et la plus récente, en juillet 1997. À cette dernière date, 12 dossiers de revendications avaient été réglés, mais des revendications éventuelles et actuelles de plus de 200 Premières nations doivent encore être évaluées ou réglées, selon le cas.

**14.2** Le gouvernement du Canada a choisi de régler ces revendications par la négociation plutôt que par la contestation judiciaire ou d'autres moyens. Affaires indiennes et du Nord Canada est le représentant fédéral attitré lors des négociations auxquelles participent d'autres ministères, s'il y a lieu. Les autres parties sont notamment les gouvernements provinciaux et territoriaux et les requérants. Le Ministère répond largement des résultats obtenus, mais il n'est pas la seule partie qui doit rendre des comptes; pour en venir aux règlements recherchés, il faut de la bonne volonté et un engagement politique de la part de tous les participants.

**14.3** Le gouvernement a indiqué que des règlements négociés établissent une certitude en matière de droits de propriété des terres et d'accès à celles-ci et à leurs ressources. Toutefois, il faut bien plus que la signature d'une entente pour chasser l'incertitude. Comme autre facteur primordial, mentionnons notamment la mise en oeuvre réussie des ententes. Celle-ci prend la forme de centaines de projets auxquels participent les parties collectivement ou individuellement. Nous avons décelé des lacunes dans cette mise en oeuvre, y compris des plans de mise en oeuvre insuffisants, voire inexistants, et avons constaté la nécessité d'améliorer la surveillance, les rapports et l'évaluation.

**14.4** Affaires indiennes et du Nord Canada n'a pas toujours fait preuve d'assez de rigueur au moment de déterminer la nature et la valeur des biens devant figurer dans les règlements finaux (sommes d'argent, terres et autres ressources).

**14.5** Il faut parfois compter plus de 20 ans pour en venir à un règlement. Les retards ont de nombreuses causes. À notre avis, les longs délais nuisent à la rentabilité (rapport coût–efficacité) du processus et peuvent mener à des résultats moins favorables pour toutes les parties intéressées.

## Chapitre 13 – Points saillants

**13.1** La *Loi sur l'Office national de l'énergie* n'a pas subi de modification importante depuis qu'elle a institué l'Office national de l'énergie, en 1959. Bien que l'Office se soit vu confier de nouvelles responsabilités dans des domaines comme les activités en région pionnière, son rôle n'a pas beaucoup changé depuis sa création. Cependant, son mode de fonctionnement s'est profondément transformé. En modifiant sa réglementation, l'Office est devenu moins interventionniste pour compter davantage sur les forces du marché, l'autoréglementation de l'industrie et la négociation de la structure des droits. Pendant cette période de transformation, l'Office a déménagé son administration centrale d'Ottawa à Calgary, réduit son effectif de 35 p. 100 et procédé à une restructuration interne pour rehausser son efficience. L'Office n'a cependant mesuré de manière objective ni l'efficacité de son programme, ni sa pertinence.

**13.2** L'Office est conscient que le vieillissement du réseau canadien de pipelines pose des risques potentiels pour la sécurité du public et l'environnement. Le nombre d'incidents signalés mettant en cause des pipelines a augmenté au cours des dernières années. L'Office met au point actuellement une méthodologie d'évaluation des risques qui devrait lui permettre de mieux cibler les inspections ainsi que les vérifications de sécurité. Il devra toutefois combler des lacunes dans sa gestion de l'information.

**13.3** L'Office pourrait ne pas être en mesure de s'acquitter pleinement de ses responsabilités en matière de réglementation de l'environnement en raison des lacunes que comporte son programme d'inspection environnementale, notamment pour ce qui est de l'établissement des priorités, du calendrier des inspections et des pratiques d'inspection trop peu formelles et mal structurées.

**13.4** Depuis 1991, l'Office recouvre la majeure partie de ses coûts auprès de l'industrie. Il n'a pas encore modifié sa méthode de répartition des coûts, même si des intervenants ont exprimé des doutes quant à l'équité de cette méthode. L'Office a choisi la simplicité aux dépens de la causalité des coûts. Il n'a pas de système de comptabilité analytique. Il doit recouvrer les coûts d'une façon que les parties intéressées jugeront plus équitable et acceptable.

**13.5** L'Office s'oriente vers une gestion axée sur les résultats. Pour ce faire, il adopte un nouveau cadre de responsabilisation ainsi qu'un nouveau mode de prise de décisions. Bien qu'il soit trop tôt pour évaluer les résultats de cette initiative, nous avons remarqué que l'Office pourrait davantage aligner sa gestion des ressources humaines sur sa vision de l'avenir. En outre, l'Office devra énoncer clairement les résultats qu'il vise et en faire rapport, surveiller son rendement de manière régulière et systématique, et établir une meilleure correspondance entre les coûts et les résultats obtenus.

# La création de l'Agence canadienne d'inspection des aliments

## Chapitre 12 – Points saillants

**12.1** Le gouvernement fédéral recourt actuellement à de nouveaux mécanismes pour améliorer la prestation de ses services. Dans cette veine, il a créé l'Agence canadienne d'inspection des aliments (ACIA), premier organisme gouvernemental de services à voir le jour par voie législative; cet établissement public est entré en fonction le 1er avril 1997. Sa principale responsabilité est de favoriser la salubrité des aliments, de protéger la santé des végétaux et des animaux et de faciliter les échanges commerciaux dans tous les domaines en offrant des services d'inspection et d'autres services connexes.

**12.2** La création de l'Agence est manifestement fondée; celle-ci est notamment l'aboutissement d'études menées depuis 30 ans sur la réorganisation du système fédéral d'inspection des aliments. En outre, le gouvernement s'était engagé à adopter des modes nouveaux et améliorés de prestation des services. Les hauts fonctionnaires des trois ministères fédéraux s'occupant de l'inspection et de la salubrité des aliments ont appuyé la mise sur pied d'une entité unique d'inspection des aliments. Cette initiative illustre clairement qu'il est possible d'apporter des changements durables lorsque ceux-ci sont clairement justifiés et qu'ils bénéficient du soutien des cadres supérieurs.

**12.3** La formation d'un groupe structuré et indépendant a joué un rôle crucial dans la mise sur pied de l'Agence. Le groupe a pu accomplir son travail sans être mêlé aux activités courantes d'inspection et de quarantaine; on a ainsi pu offrir ces services sans interruption pendant tout le processus de création de l'Agence.

**12.4** L'un des motifs favorisant l'adoption de nouveaux modes de prestation des services est d'offrir une plus grande souplesse à la gestion des ressources humaines. L'un des principaux défis que l'Agence a dû relever, lorsqu'elle a cessé d'être régie par la *Loi sur l'emploi dans la fonction publique* et a acquis le statut d'employeur distinct, fut de passer à un nouveau régime de gestion des ressources humaines. En tant qu'employeur distinct, il faut être conscient, dès le départ, de la complexité inhérente à la création d'un nouveau cadre de ressources humaines et en tenir compte.

**12.5** Dans un domaine à responsabilité partagée comme la salubrité des aliments, il est important de définir avec soin les rôles et d'établir des mécanismes qui permettront de régler les problèmes imprévus. La mise sur pied d'un cadre de responsabilisation a été au centre des préoccupations lors de la création de l'ACIA. Les ministres de l'Agriculture et de la Santé se sont vu confier des responsabilités particulières en matière de salubrité des aliments. Pendant la première année de fonctionnement de l'Agence, certains détails opérationnels restaient à régler alors que surgissaient de nouveaux problèmes.

# Agriculture et Agroalimentaire Canada

## Le programme des avances en espèces

## Chapitre 11 – Points saillants

**11.1** Le programme des avances en espèces d'Agriculture et Agroalimentaire Canada est l'un des véhicules que le gouvernement met à la disposition des producteurs de cultures entreposables pour leur donner plus de latitude lorsqu'ils prennent leurs décisions de mise en marché. Ce programme comporte des prêts à court terme consentis aux producteurs au moment de la récolte, alors que leurs obligations financières sont souvent les plus lourdes. Les fonds accordés permettent aux producteurs de faire le pont entre la récolte et le moment où ils commercialisent leurs produits et où ils commencent à en tirer des revenus. Ces dernières années, le montant annuel des prêts a varié entre 730 millions de dollars et plus de 1,2 milliard de dollars.

**11.2** Les producteurs ont fort bien accueilli le programme. Ceux avec qui nous avons communiqué aiment pouvoir disposer de liquidités prévisibles au moment de la récolte et ils apprécient le volet de l'exemption d'intérêt du programme. Bon nombre des grands programmes d'aide à l'agriculture du passé ont pris fin, et les producteurs voient en celui-ci un signe important du soutien continu du gouvernement au secteur.

**11.3** En 1993, la Direction générale de l'examen des programmes du Ministère a fait une évaluation du programme qui comportait quelques conclusions favorables sur celui-ci, mais suscitait également des préoccupations importantes, notamment au sujet du volet de l'exemption d'intérêt. Les évaluateurs ont également conclu que rien ne prouvait hors de tout doute que ce programme favorisait la commercialisation ordonnée.

**11.4** En 1997, le Parlement adoptait une nouvelle loi, la *Loi sur les programmes de commercialisation agricole (LPCA)*, qui fusionnait les deux programmes antérieurs des avances en espèces, les mettait à jour et enchâssait la disposition d'exemption d'intérêt. Le gouvernement n'a pas établi avec clarté pour quels motifs il consentait des avances sans intérêt, même si l'évaluation faisait ressortir la nécessité de définir un objectif clair pour cette composante du programme.

**11.5** La nouvelle *Loi* requiert un examen de ses dispositions et de son application, la cinquième année de son existence, soit en 2001. L'évaluation de 1993 a fourni d'importants renseignements sur l'efficacité du programme, mais, à l'instar de toute autre étude, certaines questions demeurent sans réponse; nous estimons qu'il faudrait en traiter lors du prochain examen. Il y a lieu de se demander, entre autres choses, si les producteurs éprouvent de réelles difficultés d'accès à du crédit lors de la récolte, et si l'on gère bien les pertes qui découlent de la garantie du gouvernement sur ces prêts.

**11.6** Nous avons relevé des lacunes dans la façon dont on a rendu publiques les constatations de l'évaluation sur les avances en espèces. Nous avons constaté des lacunes semblables dans la diffusion d'autres études que les directions générales du Ministère ont produites sur l'incidence et sur l'efficacité des programmes. À notre avis, un certain nombre de caractéristiques du Ministère, les lois qu'il doit appliquer et la composition de ses parties intéressées constituent autant de facteurs qui favorisent grandement une diffusion plus active à l'externe, de l'information sur l'existence et les constatations des études sur l'efficacité. Certains secteurs du Ministère prennent déjà des mesures dans ce sens.

# Commission canadienne des droits de la personne

# Comité du tribunal des droits de la personne

## Chapitre 10 – Points saillants

**10.1** En 1977, le Parlement a créé la Commission canadienne des droits de la personne et le Comité du tribunal des droits de la personne (ci-après appelé « Tribunal ») qu'il a chargés de régler les plaintes relatives aux droits de la personne de façon rapide, impartiale et experte. La Commission fait enquête sur les plaintes, puis, si elle juge qu'une instruction est justifiée, en saisit le Tribunal. Ce modèle a été choisi comme solution de rechange à la procédure officielle des tribunaux. Avec le temps, le processus est toutefois devenu lourd, long et coûteux.

**10.2** De 1988 à 1997, la Commission a reçu environ 7 450 plaintes signées, les plaintes à l'égard de la parité salariale non comprises. Elle a rendu des décisions finales dans environ 6 550 des 7 450 plaintes signées. La Commission a soit rejeté, soit décidé de ne pas instruire environ les deux tiers de ces plaintes. Environ six pour cent des plaintes ont été transmises au Tribunal pour instruction.

**10.3** Bien que des efforts considérables aient été déployés afin d'améliorer le traitement des plaintes, il faut encore beaucoup de temps pour instruire une plainte, soit en moyenne environ deux ans pour la Commission et un an pour le Tribunal. En 1997, presque la moitié des 900 plaintes présentées à la Commission faisaient encore l'objet d'une enquête un an après leur signature.

**10.4** La Commission essaie de régler les plaintes par la conciliation et le Tribunal tente à son tour de recourir à la médiation une fois que la Commission lui a déféré des dossiers pour instruction. Comme la Commission a ses propres objectifs en matière de règlement des plaintes, elle n'est pas un conciliateur neutre. Depuis 1996, environ 18 p. 100 des plaintes ont fait l'objet d'un règlement rapide ou ont été réglées au moyen de la conciliation. Il a fallu en moyenne quelque 45 mois à la Commission pour en arriver à une décision finale lorsque les plaintes faisaient l'objet d'une enquête avant d'être soumises à la conciliation.

**10.5** La Commission et le Tribunal fonctionnent dans un milieu complexe qui présente des risques élevés. Les motifs permettant le dépôt d'une plainte augmentent en nombre et les concepts entourant la discrimination gagnent en complexité. Le contexte lui-même est aussi davantage litigieux. Les crédits alloués à la Commission ont été réduits, passant de 16,15 millions de dollars en 1992–1993 à 14,8 millions de dollars en 1998–1999. De plus, le nombre des enquêteurs est passé de 37 à 25. Le roulement du personnel enquêteur de la Commission est élevé, ce qui nécessite la réattribution des dossiers à d'autres enquêteurs. Nous sommes également préoccupés par le fait que la Commission ne se conforme pas de façon suivie à certaines de ses principales normes en matière d'enquête.

**10.6** Nous constatons que la ministre de la Justice a indiqué que la *Loi canadienne sur les droits de la personne* serait soumise à un examen exhaustif. La Commission s'est réjouie de cette proposition. Le Comité sénatorial permanent des affaires juridiques et constitutionnelles, dans son troisième rapport de décembre 1997, a également réclamé une révision de la *Loi*.

**10.7** Nous convenons que le Parlement devrait mener un examen approfondi de la *Loi* et nous recommandons que le gouvernement définisse et présente au Parlement un ensemble intégré de mesures précises destinées à accroître l'efficacité du traitement des plaintes relatives aux droits de la personne. Les mesures qu'il serait possible de prendre à cet égard sont résumées dans la conclusion du présent chapitre.

## Avant-propos (suite)

Enfin, j'examine les améliorations que le gouvernement apporte à sa capacité de gestion financière et la structure qu'il crée pour permettre aux décideurs d'évaluer les conséquences financières de leurs décisions.

La réussite dans tous ces domaines dépend de l'engagement visible de la haute direction. Les gestionnaires devront obtenir l'appui de toute l'organisation pour suivre les meilleures pratiques, tirer parti des leçons apprises de l'expérience des autres et les intégrer quotidiennement à leur prise de décision.

# Rapport du vérificateur général du Canada à la Chambre des communes — Septembre 1998

## Avant-propos

Je suis heureux de présenter le volume de septembre de mon rapport de 1998. Cet avant-propos est suivi des Points saillants des neuf chapitres, qui sont publiés séparément :

10. Commission canadienne des droits de la personne
Comité du tribunal des droits de la personne

11. Agriculture et Agroalimentaire Canada — Le programme des avances en espèces

12. La création de l'Agence canadienne d'inspection des aliments

13. Office national de l'énergie

14. Affaires indiennes et du Nord Canada — Les revendications territoriales globales

15. Revenu Canada - Promouvoir l'intégrité au sein du Ministère

16. La gestion du numéro d'assurance sociale

17. Conseil d'examen du prix des médicaments brevetés

18. La Stratégie d'information financière : un outil essentiel pour repenser le rôle de l'État

Dans ce rapport, je continue d'approfondir plusieurs des questions que j'avais soulevées dans le chapitre de 1997 consacré aux questions d'une importance particulière. Il s'agit de la mise de l'accent sur les résultats plutôt que sur les intrants et les processus, de la nécessité d'assurer la reddition de comptes alors que des activités ne sont plus exercées dans le cadre traditionnel du gouvernement, de la promotion de l'intégrité au sein du gouvernement et de la possibilité de faire de la fonction de contrôleur une réalité.

Mettre l'accent sur les résultats est essentiel pour accroître l'efficacité des activités quotidiennes du gouvernement. À l'heure où la nature des organisations change et où des objectifs contradictoires sont fixés pour les programmes, il est primordial que les gestionnaires établissent des buts précis en matière de rendement des programmes, mesurent les progrès à cet égard, communiquent de l'information à ce sujet et utilisent cette dernière pour veiller à ce que le gouvernement atteigne ses objectifs. Des outils efficaces comme les évaluations peuvent jouer un rôle déterminant en fournissant aux décideurs de l'information sur la mesure dans laquelle les politiques et les programmes donnent les résultats escomptés, et sur la façon de les améliorer.

J'aborde également la question de l'adoption par le gouvernement de nouveaux modes pour assurer certains services et programmes aux Canadiens. Quelques-uns de ces modes offrent plus de souplesse dans la gestion des ressources, particulièrement celle des ressources humaines. Cependant, il demeure essentiel d'assurer la reddition de comptes à l'égard des résultats. Il faut pour cela une compréhension commune des rôles et des responsabilités, des objectifs et des attentes clairement énoncés, et la communication d'information complète et honnête sur le rendement. Le défi sera de concilier souplesse et reddition de comptes sans pour autant revenir aux modes de fonctionnement traditionnels.

Jeter une base d'éthique solide pour la promotion de l'intégrité au sein du gouvernement est une autre question que j'étudie dans ce rapport. Le gouvernement doit encourager l'instauration d'un cadre qui met l'accent sur les principes, le leadership, l'habilitation des fonctionnaires à agir dans l'intérêt public, la formation et les mécanismes de communication des préoccupations. Cependant, il faut demeurer vigilant.

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# Septembre 1998

## Avant-propos et Points saillants

AUDITOR GENERAL OF CANADA

VÉRIFICATEUR GÉNÉRAL DU CANADA

À l'honorable Président de la Chambre des communes :

J'ai l'honneur de vous transmettre ci–joint mon deuxième rapport de 1998 à la Chambre des communes, lequel doit être déposé à la Chambre en conformité avec les dispositions du paragraphe 7(5) de la *Loi sur le vérificateur général.*

Le vérificateur général du Canada,

L. Denis Desautels, FCA

OTTAWA, le 29 septembre 1998

*Le Rapport de septembre 1998 comporte 9 chapitres ainsi qu'un Avant–propos et Points saillants. Pour mieux répondre aux besoins de nos clients, il est disponible sur divers supports. Pour obtenir d'autres documents ou les obtenir sur un autre support, voir la Table des matières et le bon de commande à la fin du présent document.*

*Dans le présent rapport, le genre masculin est utilisé sans aucune discrimination et uniquement dans le but d'alléger le texte.*

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Rapport du

# vérificateur général du Canada

à la Chambre des communes

Avant-propos et Points saillants

Septembre 1998



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## Avant-propos et Points saillants

**Septembre 1998**

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Government Publications

# Report of the Auditor General of Canada to the House of Commons

## Chapter 10
Canadian Human Rights Commission
Human Rights Tribunal Panel

**September 1998**

Report of the

# Auditor General of Canada

to the House of Commons

## Chapter 10

Canadian Human Rights Commission
Human Rights Tribunal Panel




# September 1998

*This September 1998 Report comprises 9 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.*

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# Chapter 10

## Canadian Human Rights Commission

## Human Rights Tribunal Panel

*The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.*

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# Canadian Human Rights Commission

# Human Rights Tribunal Panel

## Main Points

**10.1** In 1977 Parliament established the Canadian Human Rights Commission and the Human Rights Tribunal Panel to resolve human rights complaints quickly, impartially and expertly. The Commission investigates complaints and, if it decides that an inquiry is warranted, forwards the complaint to the Tribunal for adjudication. This model was chosen as the alternative to the formal processes of the courts. However, the approach that has evolved is cumbersome, time-consuming and expensive.

**10.2** Between 1988 and 1997, the Commission received about 7,450 signed complaints, excluding pay equity complaints. It made final decisions on about 6,550 of the 7,450 signed complaints. The Commission dismissed or did not proceed with about two thirds of these complaints. About six percent of complaints were forwarded to the Tribunal for inquiry.

**10.3** Although major efforts have been made to improve the handling of complaints, it still takes a long time for a complaint to be reviewed — an average of about two years for the Commission and about a year for the Tribunal. In 1997 almost one half of the Commission's 900 open cases were still being investigated one year after the signing of the complaint.

**10.4** The Commission tries to settle complaints through conciliation and the Tribunal also tries to mediate complaints after the Commission forwards them for inquiry. Because the Commission has its own settlement objectives, it is not a neutral conciliator. Since 1996 about 18 percent of complaints have been settled through early resolution or conciliation. The Commission took an average of about 45 months to reach a final decision when complaints were investigated and then sent to conciliation.

**10.5** The Commission and the Tribunal are operating in a complex environment that poses major risks. The grounds for making a complaint are increasing and concepts of discrimination are becoming more complex. The environment also is more litigious and contentious. The Commission's total funding has been reduced from a high of $16.15 million in 1992–93 to $14.8 million in 1998–99. The number of investigators also has been reduced from a high of 37 to 25. Further, the Commission is experiencing a high turnover of investigative staff, necessitating the reassignment of cases to other investigators. We also are concerned that the Commission is not consistently adhering to some of its key investigative standards.

**10.6** We note that the Minister of Justice has stated that a broad review of the *Canadian Human Rights Act* will be undertaken. The Commission has welcomed this proposal. The December 1997 Third Report of the Senate Standing Committee on Legal and Constitutional Affairs also called for a comprehensive assessment.

**10.7** We agree that a fundamental review by Parliament is needed and recommend that the government identify and present to Parliament an integrated set of specific measures to increase the effectiveness of addressing human rights complaints. Possible measures are summarized in the concluding section of this chapter.

# Introduction

## Role of the Canadian Human Rights Commission

**10.8** The *Canadian Human Rights Act* sets out the Commission's responsibilities. The purposes of the Act are to protect individuals from discrimination and promote equality of opportunity. It applies to federal government departments and agencies, Crown corporations, chartered banks, airlines, telecommunications and broadcasting organizations, and shipping and interprovincial trucking companies.

**10.9** The Commission investigates complaints of discrimination. Complaints may relate to employment, or to the provision of goods, services, facilities and accommodation that are customarily available to the general public. The Commission also has a statutory responsibility to foster public understanding and recognition of the principles of the Act.

**10.10** Complaints of discrimination may be made based on race, national and ethnic origin, colour, religion, age, sex, sexual orientation, marital status, family status, disability or conviction for an offence for which a pardon has been granted. Complaints of discrimination based on sex include complaints about pay inequities between men and women.

**10.11** In October 1996, amendments to the *Employment Equity Act* came into force. The purpose of the Act "is to achieve equality in the workplace so that no person shall be denied employment opportunities or benefits for reasons unrelated to ability." The Commission is responsible for the enforcement of the obligations imposed on employers by the Act.

**10.12** The Commission currently consists of the Chief Commissioner and six part-time members appointed by the Governor in Council. It has about 180 full-time equivalent employees. During 1997–98, the Commission spent about $15 million and plans to spend about $14.8 million in 1998–99.

## Role of the Human Rights Tribunal Panel

**10.13** If the Commission decides, based on its investigation, that an inquiry is warranted, it refers the case to the Tribunal. The Commission then represents the public interest before the Tribunal. The Tribunal, as a quasi-judicial body, holds hearings to decide whether there has been a discriminatory practice prohibited by the *Canadian Human Rights Act*.

**10.14** During 1997–98, the Tribunal consisted of the President and about 40 Governor-in-Council-appointed active panel members. It has a staff of 14 public servants. The Tribunal's 1997–98 budget was about $1.9 million and is expected to be about $2.2 million in 1998–99.

## Focus of the Audit

**10.15** The primary focus of our audit was to examine whether:

- the existing accountability and independence frameworks ensure independence from government while still retaining appropriate accountability;
- the process for handling human rights complaints is accessible, equitable and well managed within available resources; and
- the Commission is in a position to implement its new employment equity audit mandate under the *Employment Equity Act* in a satisfactory manner.

**10.16** We reviewed the timeliness of addressing pay equity complaints. However, we did not review in detail the management and investigation procedures for such complaints because they differ significantly from other complaints and would require a separate audit. We also did not examine the Commission's human

rights promotion program because our audit of its complaints management process required more time and resources than anticipated.

**10.17** We reviewed the Tribunal's financial and management controls and its mediation process; however, we did not review Tribunal hearing procedures.

**10.18** We interviewed a wide cross section of stakeholders. The Commission and the Tribunal assisted by identifying the stakeholders they believed we should interview to obtain reliable information on the mandate and operations of both entities. Further details on our audit objective, scope and approach are found at the end of the chapter in the section **About the Audit**.

## Observations

### Canadian Human Rights Commission

**The grounds for complaints about discrimination are expanding**

**10.19** The *Canadian Human Rights Act* contains a list of specified prohibited grounds of discrimination. The grounds have evolved as a result of court decisions and amendments to the Act, which are sometimes subsequent to court decisions. The Commission tries to expand the interpretation of the Act through court cases, sometimes in collaboration with complainants' counsel.

**10.20** Requests for revisions come from members of Parliament, the Commission itself and "equality seeking groups" representing, for example, women, same sex couples, individuals with disabilities, low income individuals and different racial and ethnic communities. Exhibit 10.1 summarizes the type of requests that have been made.

**10.21** The Commission also advocates changes to the Act. For example, the Commission has decided it can address larger social issues, such as poverty, that may go beyond its immediate jurisdiction. The Commission told us "this is consistent with the overall purpose of the Act which is to guarantee equality of opportunity." Its 1997 Annual Report to Parliament recommended that social condition be included as a prohibited ground of discrimination.

**10.22** Since the Act was passed, four amendments have been made to the prohibited grounds of discrimination. Two grounds — family status and sexual orientation — were added, and the ground of disability was expanded. A fourth amendment, clarifying an organization's duty to accommodate individuals with special needs unless it causes undue hardship for the organization, was included in Bill S-5 promulgated in May 1998. The amendment follows a Supreme Court ruling as well as a series of rulings by other courts. The Bill also requires the Commission to accept and investigate complaints of retaliation against a complainant and it provides for the filing of a complaint based on multiple grounds.

**Exhibit 10.1**

**Requests for Revisions to the *Canadian Human Rights Act***

Requests for revisions to the *Canadian Human Rights Act* include:

- the prohibition of mandatory retirement;
- the prohibition of discrimination on the grounds of source of income or social condition, political belief and criminal conviction or charge;
- the removal of restrictions on the Commission's authority to deal with human rights questions concerning native peoples;
- the removal of the requirement that the victim of a discriminatory practice be "lawfully present" in Canada; and
- the establishment of enforceable standards for accessibility to facilities.

**10.23** The Federal Court is currently reviewing the constitutionality of the provision in the *Canadian Human Rights Act* that permits mandatory retirement where the retirement age is fixed by law or regulation.

**Decisions are made independently of government**

**10.24** The Commission is an investigative and decision-making body and the Tribunal is a quasi-judicial body that, like the judiciary, makes findings of fact and adjudicative decisions. These entities are expected to operate and be seen to operate independently of the government of the day.

**10.25 Organizational independence.** Government departments and the Treasury Board often are the subject of investigations and employment equity audits by the Commission and are respondents in hearings before the Tribunal. At the same time, the Treasury Board approves the budget of both agencies and both are subject to all Board regulations and policies. The Minister of Justice is responsible for the *Canadian Human Rights Act* and for the Commission and the Tribunal. As Attorney General of Canada, the Minister often represents departments in the negotiation of settlements of cases with the Commission and before the Tribunal and the courts.

**10.26** In certain instances, the perception of the independence of the Commission and the Tribunal from the government is strained. These instances involve major cases where the government, as the employer, is the respondent before the Tribunal and where additional major funding is required for lengthy hearings. In such instances, the Treasury Board is both the approver of requests for such funds and the respondent to the case being heard.

**10.27** We did not find evidence that the government is using funding controls to hamper the Commission or the Tribunal in the fulfilment of their responsibilities. In practice, we found that additional funds usually have been provided to the Commission and the Tribunal when needed. However, there is an absence of legislative safeguards.

**10.28** There are also concerns about the independence of the Tribunal from the Commission. Recently, the Federal Court found that the Tribunal was not independent of the Commission. Certain provisions of Bill S-5 are intended to address this issue.

**10.29 Independence of appointees.** Appointees to the Commission and Tribunal should be and be seen to be independent and qualified. The Governor in Council appoints full- and part-time members to the Commission and the Tribunal. Bill S-5 addresses some of the issues relating to the independence of appointees to the Tribunal; for example, it establishes qualifications for appointment to the Tribunal and extends the terms of the Chairperson for up to seven years and of Tribunal members for up to five years.

**10.30** Bill S-5 also specifies procedures for removal of members of the Tribunal. The procedures are similar to those proposed for other administrative tribunals in Bill C-44, which received first reading in June 1998.

**10.31** Other safeguards for Commission and Tribunal appointments that would help ensure the personal independence and quality of appointees include:

- increasing transparency in the appointment process by having stated criteria for qualifications and by widely advertising openings for both full- and part-time appointments;
- having a panel of experts and eminent citizens or a legislative committee interview and recommend candidates for appointment by the Governor in Council; and
- setting the salary and benefits of appointees by statute — perhaps by fixing

The Commission and Tribunal are expected to operate and be seen to operate independently of government.

Full- and part-time Governor in Council appointees are subject to the principles of the Conflict of Interest and Post-Employment Code.

them in proportion to the statutory remuneration of federally appointed judges.

**10.32** **Conflict of interest.** Like other full-and part-time Governor in Council appointees, members of the Commission and Tribunal are subject to the principles in Part I of the government's Conflict of Interest and Post-Employment Code for Public Office Holders. Both the Commission and the Tribunal require all members to certify that they are complying with the principles.

To be effective, the Commission must investigate complaints quickly, impartially and expertly.

**10.33** The Ethics Counsellor informed us that he would be writing to all part-time Governor in Council appointees to ensure that they fully understand that they are subject to the principles of the Code.

**10.34** Part II of the Code, which requires disclosure of assets and outside activities to the Ethics Counsellor, does not apply to part-time Governor in Council appointees. The Tribunal, however, requires its part-time appointees to make such a disclosure to its President or Registrar. As well, it requires compliance with its own principles for maintaining independence, impartiality, confidentiality and proper conduct.

**10.35** **Independence of reporting.** The ability to report to Parliament independently of government control is essential to the effectiveness of the Commission and the Tribunal. Bill S-5 provides for the Commission and the Tribunal to submit their annual reports directly to Parliament rather than through the Minister of Justice.

On average, the Commission takes about 27 months to investigate complaints and reach final decisions.

**Major delays still exist in processing human rights complaints**

**10.36** The Commission is required by legislation to deal with almost all of the complaints it receives and the Tribunal is required to deal with all complaints referred to it by the Commission. The responsibilities conferred have increased as a result of the expansion of the prohibited grounds of discrimination by courts and Parliament.

**10.37** Between 1988 and 1997, the average annual number of signed complaints was about 745, excluding about 175 pay equity complaints filed during this period. The Commission consolidated similar pay equity complaints and thus the total number of pay equity complaints was larger.

**10.38** To be effective, the Commission must investigate complaints quickly, impartially and expertly. In 1985 we reported that the major operational challenge faced by the Commission was to reduce the long delays in its investigation of complaints and to reduce the backlog of complaints to a reasonable level.

**10.39** The Commission has established new standards for the resolution of an "average" complaint. In 1985 the Commission's general standard was six months to process a case. Its current standard, reconfirmed by the Commission in 1990, is nine months from the date a complaint is signed to its presentation to Commissioners for decision. If Commissioners send a complaint to conciliation, then four to six months are added to this standard.

**10.40** Between January 1988 and November 1997, Commissioners reached final decisions on about 6,550 cases, excluding pay equity cases. On average, the Commission took about 27 months to reach these decisions, including 25 months to dismiss cases and 23 months to decide that there would be no further proceedings. Our calculations exclude the time between the deferral of a decision, where a "lead case" was before the Tribunal or the courts or was being investigated, and the reinitiation of consideration of such cases.

**10.41** The Commission implemented a new seven-phase system in February 1994 to expedite investigations. To take into account that a new system may not

initially operate at full efficiency, we measured the time the Commission has taken to reach final decisions since January 1996. On average, the Commission took about 23 months to reach about 1,170 final decisions. It took three or more years to reach a decision on about 16 percent of cases.

**10.42** We also assessed the extent to which the Commission met the time standards it established in 1994 for phases of the complaint management process. We measured the time taken to complete key steps for cases filed between January 1996 and November 1997. Exhibit 10.2 shows that the average time to complete key steps exceeded the Commission's standards. For example, the Commission's time standard to complete an initial investigation was about 5.5 months after a complaint was signed. In practice, the Commission took an average of about 10 months to complete initial investigations. In about 26 percent of cases, it took over one year.

Exhibit 10.2

**Comparison of Average Time Taken to Complete Investigation Phases With Commission Standards**

| Phase | Standard (Days) | Average Actual Time (Days) 1996–1997[1] |
|---|---|---|
| **Phase 1** | | |
| Intake and early resolution | 30 | 72 |
| Signing of complaint | | |
| **Phase 2**[2] | | |
| Assigning investigator | 7 | 34 |
| Screening of complaint | | |
| **Phase 3** | | |
| To notify respondent | | |
| To receive respondent reply | 40 | 60 |
| To request complainant rebuttal | 17 | 30 |
| To receive complainant rebuttal | 40 | 45 |
| To disclose investigation report to parties | 37 | 110 |
| To receive replies from parties | 15 | N/A |
| To submit documentation to Commissioners | 7 | N/A |
| **Completion of Phases 2 and 3** | 163 | 287 |
| **Phase 4** | | |
| In-depth investigation | 90 | 172 |
| **Phase 5** | | |
| Commissioners' decision | N/A | 58 |
| **Phase 6** | | |
| Conciliation | 120 to 180 | 208 |
| **Phase 7** | | |
| Hearing at Tribunal | N/A | N/A |

[1]Average actual time the Commission took to complete an activity on complaints signed from 1 January 1996 to 17 November 1997.

[2]The seven-day standard covers Phase 2 activities and the letter of notification of the parties in Phase 3.

N/A = Not available.

**10.43** Most of the delay under the control of the Commission occurs in the disclosure of the investigation report to the parties. The Commission's time standard for this step is about a month. However, between January 1996 and November 1997, it took an average of about 3.7 months to complete this step; in about 23 percent of the cases, it took more than 5 months.

**10.44** Significant delays also result from the Commission not having the legal authority to enforce deadlines. For example, the Commission requests that respondents reply to a complaint within 40 days of notification. The average reply, however, takes 60 days, with about 15 percent of respondents taking 90 days or more to reply. In such instances, the Commission's only recourse is to send additional reminders to provide the information.

**10.45** If a case is sent to Tribunal or appealed to the Federal Court, it could take several years from the day a complaint is signed with the Commission for a case to be resolved. Some stakeholders suggested that the parties be allowed to take their cases directly to the Tribunal or the Federal Court for a hearing on the merits of their case. This could decrease the time and cost of resolving complaints, particularly when complainants and respondents have significant resources and expertise.

Between 1991 and 1995, the Commission's backlog ranged from 62 to 72 percent of its open cases.

**10.46** The role of the Tribunal would need to be reconsidered if complaints were brought directly to the Court. To protect the public interest, the Commission could have a statutory right to be an intervener in all cases.

**10.47** **Pay equity complaints.** Reliable data on the time it takes to process pay equity complaints are available for complaints filed since January 1993. Commissioners have reached decisions on 13 of the 36 pay equity complaints filed since this date, taking an average of about 1.5 years. About one half of the complaints have either been dismissed or not pursued by the Commission. On average, the remaining 23 complaints have been on file with the Commission for over three years.

**10.48** Large pay equity complaints may take years to resolve because the proof required to sustain an allegation is complex and court challenges are frequent.

**The Commission is encountering problems eliminating its backlog**

**10.49** The Commission considers a complaint to be in its "backlog" if it is still actively being investigated nine months after being signed. In 1997 the Commission had about 900 open cases, of which about 48 percent were in its backlog. About the same percentage of cases were still being investigated one year after they had been signed. Exhibit 10.3 provides an overview of the Commission's workload during 1991 to 1997.

**10.50** In 1989–90, the Commission received a permanent annual funding increase of about $411,000 for nine full-time additional investigators to eliminate its backlog over a five-year period. In addition, to reduce its backlog, the Commission spent almost $1 million between 1992–93 and 1997–98 to hire contractors to conduct investigations. This amount included additional one-time funding of $400,000 from the Treasury Board in 1992–93.

**10.51** Between 1991 and 1995, the backlog ranged from about 62 to 72 percent of the Commission's open cases. There are differences of opinion on why the backlog was not reduced as planned. The Commission's December 1991 submission to the Treasury Board included a request for an additional $1.82 million over four years to reduce its backlog. The submission noted that the initial funding has been based on an underestimate of the

number of new signed complaints that it would receive.

**10.52** The Treasury Board declined to provide further resources beyond the 1992–93 one-time spending authority of $400,000, because resources it had previously provided to the Commission for investigations were being used to encourage complaint volume and for other discretionary activities. The Commission was informed that further resources would not be provided until it demonstrated that it had assigned priority to investigations and conciliations by reallocating existing resources to restore its capacity in these areas.

**10.53** The Commission is considering requesting additional one-time funding of $1 million to reduce its backlog of cases over a two-year period.

### Most complaints are not proceeded with or are dismissed

**10.54** Exhibit 10.4 summarizes decisions by Commissioners.

Commissioners have dismissed or decided not to proceed with almost two thirds of signed complaints.

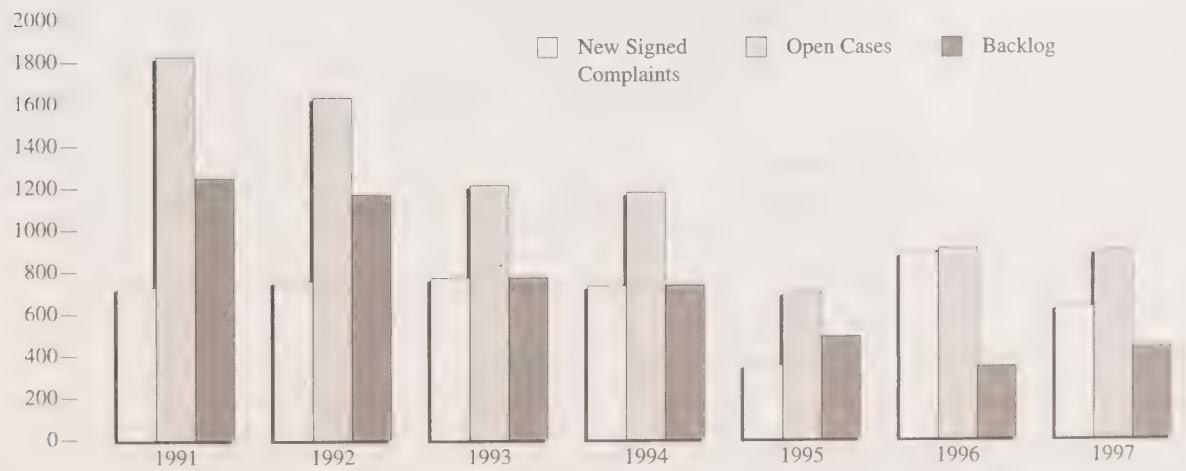
**10.55** A dismissal decision results when Commissioners decide there is a lack of evidence to support the allegation. Most of the time, the Commission does not proceed with a complaint because the complaint has been resolved by the parties, the complainant wants to discontinue action or has not responded to requests for information, or the respondent is no longer available. However, the Commission did not record explanations for over one third of the cases where a decision was made not to proceed.

### The investigation environment is complex and poses major risks

**10.56** Investigations are taking place in a difficult environment. The prohibited grounds of discrimination are increasing and are becoming more complicated. The environment also is more litigious and contentious. The courts have required the Commission to disclose more information to the parties and recommended that the

Exhibit 10.3

**Commission Workload of Signed Complaints: 1991–1997[1]**




[1]Does not include about 125 complaints settled annually by early resolution without the signing of a formal complaint and a decision by Commissioners. Backlog is defined by the Commission as complaints that are still being actively investigated nine months after being signed.

Commission provide reasons for its decisions. As described earlier, the Commission also is experiencing problems completing its investigations in a timely manner and eliminating its backlog of cases.

**10.57** The roles of the Commission to promote and advocate human rights and to impartially investigate complaints also add to the complexity of the environment. This duality of roles requires that the Commission balance its advocacy role with the need to investigate or conciliate complaints in a manner that is timely and that maintains the credibility of its impartiality.

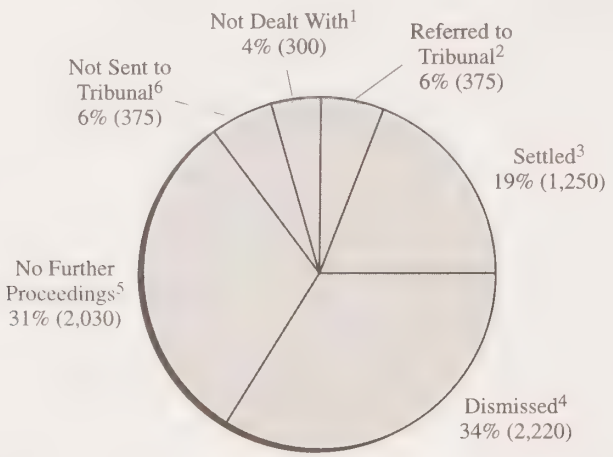
**10.58** Stakeholders have many concerns about various aspects of the Commission's operations. These include:

- a potential conflict of interest among the different roles of the Commission — advocating social policies, helping to draft complaints, investigating complaints, conciliating complaints, representing the public interest before the Tribunal and the courts, and sometimes collaborating with complainants' counsel to expand the interpretation of the *Canadian Human Rights Act*;

- the Commission's investigations being too cursory and cases being dismissed without full investigation;

Exhibit 10.4

**Disposition of 6,550 Signed Complaints With Final Decisions: 1988–1997**




**Commission's Explanation of Disposition Outcomes:**

[1]**Not Dealt With:** The Commission did not accept a signed complaint because it did not meet the criteria in section 41 of the *Canadian Human Rights Act*.

[2]**Referred to Tribunal:** A *prima facie* complaint has been established and investigation determines sufficient evidence to warrant a Tribunal hearing.

[3]**Settled:** Cases settled through conciliation or during the investigation.

[4]**Dismissed:** The Commission decided there was not enough evidence to warrant sending the complaint to Tribunal.

[5]**No Further Proceedings:** The matter has been resolved between the parties; the complainant does not respond to a request for information or wants to discontinue the investigation; or the respondent is no longer available.

[6]**Not Sent to Tribunal:** Complaints where an investigation has been completed, conciliation has failed, and the Commission believes it is not in the public interest to send the case to the Tribunal.

- the delays in processing cases undermining the fairness of the process;

- the Commissioners, without giving clear reasons, dismissing complaints or not pursuing them when conciliation fails; and

- the Commissioners not providing sufficient information on the reasons for their decisions.

**10.59** Like other government entities, the Commission's funding has been reduced. The Commission's total funding was reduced from a high of about $16.15 million in 1992–93 to $14.8 million in 1998–99. The 1998–99 funding level includes about $800,000 to conduct employment equity audits. In response to funding reductions, the Commission downsized its regional offices, centralized its investigation function in Ottawa, and reduced the number of investigators from 37 to 25.

**10.60** Since downsizing its regional offices and centralizing investigations, the Commission has experienced a high turnover of its investigation staff. Because staff from the regions did not accept transfers to the National Capital Region, the Commission had to hire 14 new investigators. Since 1995, 15 investigators have left the unit that handles most complaints, six within a year of being hired. As a result, a series of investigators often work on the same case. The Commission told us it takes about a year for an investigator to become fully functional. Currently, 14 of the 22 investigators in this unit have less than a year's experience.

**10.61** The Commission rarely uses its authority to initiate complaints because it has been challenged in the courts and lengthy litigation has ensued. One of the major grounds for challenges is that there is an "apprehension of bias" because the Chief Commissioner approves the initiation of the complaint and then presides over a meeting of Commissioners to decide whether the complaint is valid. As a result, the Commission told us that "in situations where the Commission is interested in pursuing an issue, it has found that there are usually third parties who are willing to file a complaint."

**10.62** The Commission's work is subject to judicial review by the Federal Court. To date, the Court has generally upheld the Commission's decisions, although it has sometimes expressed significant concerns about how the Commission has managed complaints. Recent decisions of the Federal Court that found a lack of sufficient independence of the Tribunal from the Commission and errors in law relating to pay equity by the Commission may result in more challenges to its jurisdiction and impartiality.

**Clear investigative standards are needed to manage the risks**

**10.63** We believe that it is essential that the Commission's investigations be rigorous because of the difficult operating environment and because the investigations form the basis for decisions involving fundamental human rights.

**10.64** The *Canadian Human Rights Act* provided for the passage of regulations establishing procedures to be followed by investigators. However, the Commission has chosen to establish administrative standards rather than regulations.

**10.65** The Commission's standards are contained in its Compliance Manual and Training Manual. The Compliance Manual states that the "manual includes procedures, directives and technical descriptions intended to ensure that compliance activities are performed in a fair, consistent and timely manner by Commission staff."

**10.66** We requested that the Commission provide us with its most up-to-date compliance and training manuals and keep us informed of any changes to them. The Commission

provided us with its 1994 Compliance Manual and 1995 Training Manual. Based on this information, we concluded that the Commission's investigation standards were generally satisfactory. However, we could not conclude that numerous directives on investigation procedures issued since January 1994 had been integrated into the manuals, or codified in any way. The Commission also could not confirm that it had provided us with the total number of directives issued on these matters.

**10.67** Subsequent to finalization of our audit report, the Commission informed us that it had almost completed revising its Compliance Manual. We plan to review the investigation standards in the revised Manual in our follow-up audit.

Based on their own and their supervisor's judgment, investigators depart from Commission investigation standards.

**10.68** We assessed the Commission's investigation procedures to determine whether the Commission was adhering to its own standards. This involved reviewing the Commission's investigation files that it identified as representative of its standard of good investigations. We selected a random sample of 50 complaint files for further review.

**10.69** The relevant information for the investigation of a complaint is supposed to be contained in four key documents: the Complaint Analysis and Assignment Form, the Investigation Plan, the Complaint Analysis Report and the Investigation Report.

**10.70** Based on their own and their supervisor's judgment, investigators depart from Commission standards. We found that the Complaint Analysis Report and the Investigation Report are completed as required. However, the documents that precede these reports — the Complaint Analysis and Assignment Form and the Investigation Plan — often are not completed. These two documents are supposed to contain information identifying the type of discrimination involved, the objectives of the investigation, the type of evidence required to substantiate whether the form of discrimination has occurred, and the sources of evidence.

**10.71** The Commission told us that the information required by these documents could be found in the letter of notification to the respondent and in the Investigation Report. However, we could not conclude that the key information could be found in these documents.

**10.72** We also found that the results of key discussions between investigators and supervisors as well as of telephone discussions and interviews with the parties often are not recorded in the files. As well, the chronology of the processing of the complaint submitted to Commissioners with investigation reports does not have sufficient information to allow them to understand the reasons for delays or their impact on the investigation process.

**10.73** The Commission told us that our findings focussed on procedural matters rather than the quality of investigations. We explained, however, that to comment on the quality of investigations would require that we verify the accuracy of the investigations conducted by the Commission. This would be costly, time-consuming and impractical. Thus, we focussed on the Commission's adherence to its key investigative standards that it established to ensure that quality is built into investigations from the start.

**10.74** We are concerned that the Commission is not consistently adhering to some of its key investigation standards that are designed to ensure the quality of investigations. Since it is investigating allegations of violations of fundamental rights, the Commission needs clear standards that should be followed for the conduct of investigations.

**10.75** The Commission needs to have clear and required investigation standards that would allow the Commission and

others to ensure accountability and transparency in the investigation and decision process. In addition, clear standards are needed for the disclosure of information to complainants and respondents during investigations and on decisions. Such standards also would help increase the confidence of stakeholders in the Commission. Further, they would help the Commission manage risks arising from a complex and litigious environment where investigations may last on average two years and where there is a high turnover in staff, requiring the Commission to rely on inexperienced investigators.

**10.76** We also believe it is important that the Commission conduct periodic audits of its investigations. The Commission's plans to conduct such audits in 1995–96 were not implemented.

**The conciliation process needs to be improved**

**10.77** The settlement of a complaint involves the parties reaching a mutually satisfactory agreement. The Commission tries to settle complaints through conciliation prior to the signing of a complaint, during investigation and after investigation. The Tribunal also tries to settle complaints through mediation after the Commission forwards them for an inquiry. Stakeholders believe that the Commission should try to settle complaints as early as possible. A complainant can withdraw the complaint at any time and settle privately with the respondent.

**10.78** We estimate that since 1996 about 18 percent of cases have been settled through some form of conciliation — 11 percent through early resolution before or during investigation, with or without the assistance of the Commission. The 7 percent sent to conciliation after investigation were, on average, before the Commission for about 45 months before a final decision was made. The conciliation phase alone took an average of about 11 months to complete. About 60 percent of the cases sent to conciliation after investigation were settled.

**10.79** Commission conciliators are usually drawn from the ranks of investigators. On average, conciliators receive about six days of conciliation-related training over several years.

**10.80** The Commission wears several hats in the conciliation process: it facilitates a settlement between the parties, it provides information on precedents, it protects the public interest and it approves the settlement.

**10.81** The Commission is not a neutral third party in the conciliation process. Conciliators formulate objectives for the settlement based on the investigation file and their knowledge of Commission policies and Tribunal precedents. They then prepare a conciliation plan for approval by their supervisors, outlining the maximum conciliation objectives. The plan is prepared and approved without talking to the parties and conciliators do not necessarily disclose to the parties that they have their own conciliation objectives.

**10.82** Complainants are generally contacted by telephone to find out what settlement would be acceptable to them. Subsequently, the settlement request is presented to respondents. The actual person against whom the allegation of discrimination has been made is rarely involved in the conciliation process. The "respondent" contacted is usually a professional representative of the organization employing the person against whom the complaint was made. Complainants usually represent themselves.

**10.83** We believe that the Canadian Human Rights Commission's conciliation efforts would be improved by using mediation upon receipt of a complaint. We

The Commission tries to conciliate complaints before sending them to the Tribunal and the Tribunal tries to mediate complaints after they are sent to it by the Commission.

The Commission's conciliation effort would be improved by using neutral third-party mediation upon receipt of a complaint.

note that the Ontario Human Rights Commission has reported that it recently initiated a voluntary mediation program to resolve cases in the early stages of complaint processing. The Ontario Commission acts as a neutral third party with a strict separation between its mediation and investigation functions. However, it reserves the right to reject settlements that it does not believe are in the public interest. Its mediators receive extensive training before conducting mediations. During the first year of operation of the program, the Ontario Commission reported that 60 percent of the parties have opted for mediation, resulting in an 81 percent settlement rate within 91 days of the filing of a complaint.

**10.84** The establishment by the Commission of a similar mediation program could result in complaints being resolved sooner and with less cost. As explained earlier, allowing parties to take their cases directly to the Tribunal or Federal Court could also have the same result, particularly when the parties have significant resources and expertise. Together these measures could allow the Commission to refocus its investigative resources.

**Employment equity compliance audit plans are satisfactory**

**10.85** The purpose of the *Employment Equity Act* is "to achieve equality in the workplace." The Act applies to about 410 entities, including government departments and agencies, Crown corporations, and private sector companies. These entities are subject to compliance audits by the Commission. Among the private sector companies are chartered banks, airlines, trucking companies and broadcasting and telecommunications organizations. The 410 entities employ about 860,000 persons. The Commission is responsible for the enforcement of certain obligations required of employers by the Act. Exhibit 10.5 summarizes these obligations.

**10.86** The Act empowers the Commission to conduct compliance audits. It also requires that the Commission, wherever possible, resolve cases of non-compliance "through persuasion and the negotiation of written undertakings." However, as a last resort, the Commission may issue a "direction" requiring the employer to take specified actions to remedy non-compliance.

**10.87** While the amendments to the *Employment Equity Act* came into force in October 1996, employers were given one year to comply with the Act prior to audits being conducted. In January 1997, the Commission established an Employment Equity Branch to conduct compliance audits. In 1996–97, the Commission spent about $1.2 million to prepare for compliance auditing and conducted voluntary audits to test audit procedures. The Commission's plans call for the expenditure of about $6 million on employment equity activities from 1997–98 to 1999–2000.

**10.88** The Commission plans to audit all 410 entities over a five-year cycle starting in October 1997. It expects that

Exhibit 10.5

**Summary of Obligations of Employers Under the *Employment Equity Act***

Obligations of employers under the *Employment Equity Act* include the following:

- Eliminate employment barriers and institute positive employment equity policies.
- Collect information to determine the under-representation of designated groups in each occupational group in the work force.
- Prepare and implement employment equity plans.
- Inform employees about employment equity plans.
- Consult and collaborate with employee representatives to implement employment equity.
- Maintain records on the implementation of employment equity.

audits will take between 30 and 60 days, depending on the size of the entity's work force. It also expects that the time needed to conduct the first audits will be reduced because most employers will have only begun to respond to the requirements of the *Employment Equity Act*.

**Employment equity audits are complex**

**10.89** The Commission's audit criteria include 12 major categories encompassing 40 criteria. In practice, the audits require that employers establish plans to ensure that designated groups are fairly represented in their work force. Exhibit 10.6 describes the designated groups.

**10.90** Employers are required to determine whether under-representation exists by comparing the representation of designated groups in their organizations against their "work force availability". The Commission uses the term "work force availability" to describe the number of persons in a designated group in the general or regional population that have the appropriate qualifications. Employers also are required to make several comparisons for each designated group where under-representation has been found. Exhibit 10.7 summarizes the Commission's employment equity audit criteria, including the comparisons that employers must make.

**Employment equity audits require employers to establish plans to ensure that designated groups are fairly represented in their work force.**

The employment equity designated groups are:

- Women
- Aboriginal peoples
  - Indians
  - Inuit
  - Metis
- Persons with disabilities with long-term or recurring physical, mental, sensory, psychiatric or learning impairments:
  - who believe themselves, as a result of the impairment, to be disadvantaged; and
  - who believe that, as a result of the impairment, an employer is likely to consider them to be disadvantaged.
- Members of visible minorities, other than Aboriginal peoples, who are non-Caucasian in race or non-white in colour.

**Exhibit 10.6**

**Employment Equity Designated Groups**

Organizations should have :

- plans to ensure that designated groups are fairly represented in their work force;
- assessments of their work force to determine the degree of under-representation of designated group members in each occupational group;
- comparisons for each designated group where under-representation has been found, including the:
  - shares of hiring of under-represented groups' members with external representation of groups in the general or regional population;
  - shares of promotions group members have received with internal representation in the organization;
  - termination rates of the group members with the termination rates for non-designated group employees in the organization;
- employment policies and practices that do not contribute to under-representation of designated group members.

**Exhibit 10.7**

**Summary of Commission Audit Criteria for the Assessment of Organizations**

**10.91** Employers will have to use reliable estimates of representation of designated groups in the appropriate population, and employees will have to co-operate by voluntarily self-identifying as a member of a designated group. Without this information, inaccurate employment equity hiring targets and practices may result. Also, without a sound analysis of employment policies, certain employment practices may be initiated without a good understanding of the source of the problem of under-representation.

**Performance reporting on complaints management needs to be improved**

**10.92** While bodies such as the Commission and Tribunal need to be independent of government, appropriate accountability procedures for the expenditure of public funds are necessary. Parliament needs information that provides assurance that the members of such bodies are working diligently, within their mandate, and that the agencies are operating efficiently and effectively.

**10.93** The Commission currently provides to Parliament an Annual Report and an annual fall departmental Performance Report.

Despite major investments, the Commission believes that the information in its complaints management system is unreliable.

**10.94** The information the Commission provides on its management of complaints of discrimination could be significantly improved. The Commission provides only summary information on the number of complaints filed and their disposition. It could improve its performance reporting by providing information on the delivery of services against defined standards.

**10.95** The Commission also could establish objectives and numerical targets for its operations and for improvements. For example, it could set goals for the number of new complaints that should be resolved in a fiscal year, establish deadlines for eliminating its backlog, and set targets for the number of complaints that could be settled by early resolution within a specific period of time. This information could be reported for the previous and current fiscal years and for a five-year average. Similar goals and performance measures could be developed for pay equity complaints and promotion activities.

**10.96** Useful information on employment equity is contained in the Commission's 1997 Annual Report. Charts are provided comparing the representation of the four designated groups by departments and agencies of government and the private sector. Crown corporations are included with private sector companies. The report also describes the most common problems encountered by organizations in complying with the *Employment Equity Act*. However, information on the cost and progress of audits could be added.

**Cost effectiveness of new information technology needs to be better assessed**

**10.97** Since 1992, the Commission has spent approximately $3 million to implement new information technology systems. The Commission employs four full-time equivalent analysts to maintain the systems. It spends about $750,000 annually — about five percent of total expenditures — to support its information systems. The Commission's spending on information systems is similar to that of public sector organizations of the same size with similar activities.

**10.98** We focussed on the Commission's complaints management system because it is one of the main management instruments for the Commission's key functions — the investigation and conciliation of human rights complaints. Since 1992, there have been two major development projects costing about $900,000. A third iteration has just begun and the Commission plans to spend up to $300,000 over the next two years to replace the system.

**10.99** Despite these major investments, management believes that much of the information derived from the system is unreliable. Consequently, it supplements the information by other measures intended to validate the information in the system or to replace it. However, we verified the accuracy of the information in the system and used it to assess the key aspects of the timeliness of complaint processing. The Commission's system was not designed to readily produce this information.

**10.100** The Commission has recently completed a user need analysis and has prepared data and criteria to be used to evaluate alternatives for its new system. We are concerned that the Commission has not clearly defined key objectives and operational benchmarks for the new system that would allow it to assess gains in efficiency and effectiveness from this investment. The gains could be measured in terms of productivity improvements, reduction in task time, and reduction in delays prevented by accurate and timely reporting on case management.

### Clear authority and improved management controls for contribution agreements are needed

**10.101** Our major concern is about authority and management controls for international projects that the Commission undertakes on behalf of the Canadian International Development Agency (CIDA).

**10.102** CIDA funds the projects under a document called an "Agreement" signed by CIDA and the Commission. To date, the total value of the agreements is about $2.6 million over a four-year period. The Commission spends about $60,000 annually administering the agreements.

**10.103** After obtaining funds from CIDA, the Commission enters into contribution agreements with non-governmental organizations and provincial human rights commissions to carry out the projects outlined in the Agreements between CIDA and the Commission. Agreements have been signed to support human rights commissions in two countries.

**10.104** We are concerned about a lack of clear authority for the Commission to enter into these types of agreements with CIDA. We also could not identify a clear authority for the Commission to sign contribution agreements with third parties. Further, the Treasury Board must approve the terms and conditions of contribution agreements unless the Board has delegated such authority. We found that the Commission did not obtain the needed approval, nor had the Board delegated the authority.

**10.105** The Commission's financial controls for its contribution agreements are generally satisfactory; however, its management controls need improvement. The Commission cannot readily assure CIDA that it is managing and co-ordinating the projects, ensuring effective control of project resources and ensuring that procurement of materiel is in accordance with established Canadian government procedures.

**10.106** The Commission agrees that the management of its international projects has presented difficulties. It "now recognizes that it must take a more hands-on approach," and has recently taken steps to improve its management of the contribution agreements. These measures include making on-site visits, requiring status reports, and documenting decisions.

## Human Rights Tribunal Panel

### Financial controls are generally satisfactory

**10.107** The Tribunal's largest expenditure is on professional and special services, including remuneration to Panel members and contracts for translation services and temporary office support. In 1997–98, the Tribunal spent about

$1 million for such services. We found the financial controls for these expenditures to be generally satisfactory.

**The Tribunal process is lengthy**

**10.108** Like the Commission, the Tribunal was established to resolve allegations of discrimination quickly and expertly. As indicated, between 1988 and 1997, Commissioners reached final decisions on 6,550 complaints. They decided to refer about six percent of these complaints to the Tribunal. During the period 1996 to 1997, 33 cases were sent to the Tribunal.

Between 1988 and 1997, the Commission sent about six percent of complaints received to the Tribunal.

**10.109** The steps in the processing of a complaint at the Tribunal include a pre-hearing meeting, mediation, if all parties agree, and the hearing of the complaint if mediation fails. A one- or three-member panel can hear a case. Until recently, when a one-member Tribunal's decision was appealed, a three-member Review Tribunal was set up to review the decision. Since 1979, there have been 47 review tribunals. The provision for review tribunals was removed by Bill S–5. Parties may challenge a decision by requesting the Federal Court to conduct a judicial review. Sometimes the Commission asks for judicial reviews of decisions of tribunals.

Since 1996, the Tribunal has taken about a year to complete hearings and render decisions on cases that are not settled through its mediation efforts.

**10.110** Since 1996, the Tribunal has taken an average of about a year to complete hearings and render decisions on cases that are not settled through mediation. Decisions are rendered on average about five months from the last day of the hearing. Pay equity cases may take more than 100 days of hearing and cost more than $700,000. This cost does not include the costs incurred by the parties.

**10.111** Since January 1996, 19 Federal Court decisions on Tribunal findings have been reported, with 11 decisions holding against the Tribunal. The most common finding was that Tribunals made errors in law.

**10.112** Overall, stakeholders believe the Tribunal's approach to conducting hearings is cumbersome. They expressed concerns about the length of hearings, in part due to the inefficient hearing procedures and the need for part-time members to juggle their schedules.

**10.113** As indicated, legislation recently approved by Parliament resolved some of these concerns. Bill S-5 specifies the qualifications for new panel members, and lengthens the terms of the Chairperson and Vice-Chairperson from five to up to seven years. It also may reduce scheduling problems by providing for the appointment of full-time members.

**The Tribunal's approach to mediation is generally satisfactory**

**10.114** The Tribunal started to mediate complaints sent to it by the Commission in 1996. The parties voluntarily choose mediation and the Tribunal mediator is impartial. There may be several different parties in a case. About 56 percent of parties opt for mediation at the time of the pre-hearing conference. It takes about two months to complete the mediation effort, with a settlement rate of about 70 percent.

**10.115** However, the Tribunal does not have the statutory authority to mediate complaints. It also does not have formal standards and policies governing mediation and the mediators rely on their own experience.

**Performance reporting needs to be improved**

**10.116** The Tribunal's fall 1997 Performance Report to Parliament stated that its objective is to provide Canadians with "a fair, impartial and efficient public inquiry process for the enforcement and application of the *Canadian Human Rights Act* and the *Employment Equity Act*." The report provides useful information on the Tribunal's average cost per case by both ground and year, on the average number of hearing days per case by ground and by year, on the number of

cases resolved through Alternative Dispute Resolution and on the outcomes of cases.

**10.117** The Tribunal's Performance Report states that it will achieve its objective by demonstrating, for example:

- timeliness of the hearing and decision process;
- increased use of Alternative Dispute Resolution processes; and
- well-reasoned decisions, consistent with the evidence and the law.

**10.118** We believe that establishing targets such as reducing the average costs and hearing days by a specified percentage could enhance reporting.

**10.119** We noted that the report does not contain information on the elapsed time between hearing a case and rendering a decision. We found that it takes on average about a year for tribunals to complete hearings and render a decision on complaints referred to it by the Commission. However, more complex cases can take much longer.

## Conclusion and Recommendation

**10.120** In 1977 Parliament established the Canadian Human Rights Commission and the Human Rights Tribunal Panel to resolve complaints about human rights quickly, impartially and expertly. This model was chosen as the alternative to the formal legal processes of the Federal Court. However, the approach that has evolved is cumbersome, time-consuming and expensive.

**10.121** The Commission and the Tribunal are operating in an increasingly litigious and complex environment that poses major risks. In general, while stakeholders appreciate that the Commission and the Tribunal are dealing with difficult matters, they have major concerns about the efficacy of the process.

**10.122** The Minister of Justice has stated that a broad review of the *Canadian Human Rights Act* will be undertaken. The Commission has stated that this should be done sooner rather than later. The December 1997 Third Report of the Senate Standing Committee on Legal and Constitutional Affairs also called for a comprehensive assessment. We agree that a fundamental review by Parliament is needed. The various issues we have identified are for the most part interrelated and cannot be easily addressed individually.

We agree that a fundamental review of the Commission and Tribunal by Parliament is needed.

**10.123 The government should identify and present to Parliament an integrated set of specific measures to improve the effectiveness of addressing human rights complaints. Such measures could:**

- **provide for periodic reviews by Parliament of the relevance and impact of the grounds of discrimination;**
- **broaden the choice of ways that complainants and respondents could use to resolve human rights complaints, possibly permitting complainants to take cases directly to the Tribunal or the Federal Court;**
- **clearly separate the Commission's roles as promoter of human rights, investigator and conciliator of complaints, representative of the public interest and advocate for an expanded interpretation of the *Canadian Human Rights Act*;**
- **ensure that the Commission and the Tribunal are independent and accountable;**
- **provide for greater transparency in appointments to the Commission and Tribunal;**
- **establish statutory deadlines for the receipt and disclosure of information to and by the Commission;**

- **ensure that specific standards are established and followed that safeguard the reliability, impartiality and transparency of the investigation, conciliation and decision-making processes;**

- **require clear, complete and timely disclosure of reasons for decisions;**

- **require parties to consider voluntary mediation by a neutral independent mediator, early in the complaint management process;**

- **ensure that there is legislative authority for the mediation policies and procedures that may be used by the Commission and Tribunal;**

- **require greater disclosure of information on performance against defined service standards; and**

- **ensure that there are legislative authority and resources to undertake international projects.**

***Canadian Human Rights Commission's response:*** *In general, the Commission finds the report's observations helpful, and has already begun to address some of the major recommendations.*

*With respect to the complaints process, the Commission recognizes that the time taken to deal with complaints is unsatisfactory. This is a problem faced by all human rights commissions, and one that for the Canadian Human Rights Commission has been exacerbated by past budgetary reductions and difficulties arising from the current law. We anticipate that the general review of the* Canadian Human Rights Act *announced by the Minister of Justice will provide the opportunity to consider alternatives to the current approach. In the meantime, we will continue to seek ways to speed up the process, including making greater use of mediation. It is also the Commission's intention to seek one-time funding from the Treasury Board to reduce the current backlog of complaints.*

*In terms of the quality of investigations, we continue to believe that complaints are properly investigated and that the Commissioners are provided with the information they require to make informed decisions. Some of the standards noted in the report were put in place at a time when the Commission's workload was less demanding, and their contribution to the investigation process may need to be reassessed.*

*As the report points out, providing assistance to human rights institutions in other countries is a new area of activity, which has increased significantly over the past few years. The Commission intends to seek confirmation of its mandate in this area, and to ensure that the resources and systems required to meet the demand effectively are in place.*

*As a final point, we should note that the audit does not examine the Commission's promotion activities. These are an important element in the Commission's statutory mandate.*

***Human Rights Tribunal Panel's response:*** *We are in general agreement with the conclusions and recommendations contained therein that pertain to the Tribunal Panel.*

# About the Audit

## Objective

The objective of the audit was to determine whether:

- the activities of the Canadian Human Rights Commission and the Human Rights Tribunal Panel are consistent with their mandates under the *Canadian Human Rights Act* and *Employment Equity Act*;
- appropriate accountability and independence frameworks are in place to ensure independence from government with appropriate complementary accountability, including whether results are usefully measured and reported to management and Parliament;
- the process for handling human rights complaints is accessible, equitable and well managed within available resources;
- the Commission is in a position to implement its new employment equity audit mandate under the *Employment Equity Act* in a satisfactory manner;
- information technology planning is adequate; and
- financial risks are well managed.

## Scope and Approach

We interviewed Commission and Tribunal officials. We discussed mandate, accountability and independence issues, and the operations of the Commission and Tribunal with a wide cross section of stakeholders. We asked the Commission and the Tribunal to help identify the stakeholders we should interview to obtain reliable information on the mandate and operations of both entities. We interviewed these stakeholders as well as others to whom these parties referred us. We also examined reviews of provincial human rights commissions and obtained information for comparison purposes from provincial and other national human rights commissions and ombudsmen.

We reviewed the information provided by the Commission and the Tribunal to Parliament in their Estimates, annual reports and performance reports. We also reviewed decisions of the Federal Court and the Supreme Court on the Commission and the Tribunal. In addition, we examined relevant studies conducted by the Commission and the Tribunal.

We verified and used the data in the Commission's complaint management system to describe the nature and disposition of complaints received by the Commission and the timeliness of dealing with complaints. Manuals and policy documents of the Commission and the Tribunal were reviewed and a stratified random sample of 50 investigation complaint files and a random sample of 20 conciliation files were examined.

We examined the Commission's audit plans for implementing its new employment equity mandate. We compared the Commission information technology planning practices with those recommended by the Treasury Board and those used by comparable agencies.

We examined financial and management controls relating to pay and benefits, contracts and contribution agreements.

## Criteria

In assessing the Canadian Human Rights Commission and the Human Rights Tribunal Panel, we used as audit criteria management standards and policies, Treasury Board policies, and practices in and studies on comparable commissions and tribunals.

## Audit Team

Assistant Auditor General: David Rattray
Principal: Alan Gilmore
Directors: Frances Taylor, Diane Charron

Greg Boyd
John Cathcart
Allison Fader
Camille Gilbert
Sue Morgan
Janice Murray

For information, please contact Alan Gilmore.

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# Report of the Auditor General of Canada to the House of Commons

## Chapter 11
Agriculture and Agri-Food Canada – Cash Advance Program

**September 1998**

# Report of the Auditor General of Canada to the House of Commons

## Chapter 11
Agriculture and Agri-Food Canada –
Cash Advance Program




**September 1998**

*This September 1998 Report comprises 9 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.*

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# Chapter 11

## Agriculture and Agri-Food Canada

## Cash Advance Program

*The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.*

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# Agriculture and Agri-Food Canada

## Cash Advance Program

## Main Points

**11.1** The Department's cash advance program is one vehicle the government makes available to producers of storable crops to provide additional flexibility in making marketing decisions. It consists of a short-term loan made available at harvest, a time when financial obligations of producers are often at their peak. The financing provides a bridge for producers until they market their crop and begin to earn revenue. In recent years, the annual amount of these loans has ranged from $730 million to over $1.2 billion.

**11.2** The program has been very well received. Producers we contacted liked the availability and predictability of cash flow at harvest time, and the interest-free feature of the program. Many of the large agricultural assistance programs of the past have ended, and producers see this program as an important sign of continuing government support for the sector.

**11.3** In 1993, the Department's Review Branch completed an evaluation that reached some positive conclusions about the program, but also raised some significant concerns, particularly with the program's interest-free nature. It also concluded that there was no firm evidence that the program contributes to orderly marketing.

**11.4** In 1997 new legislation, the *Agricultural Marketing Programs Act (AMPA)*, was passed that updated and consolidated the two previous cash advance programs into one, and made permanent in legislation the interest-free provision. The rationale for providing advances interest-free was not made clear by the government, despite the evaluation's finding that a clear objective for this component was needed.

**11.5** Under the new legislation, a review of the provisions and operations of the Act must be completed in the fifth year of operation, which begins in 2001. The 1993 evaluation furnished important information about the program's effectiveness; however, as in any study, some questions remain unanswered that we believe should be addressed in the coming review. Among others, these include whether producers indeed face a significant problem of access to credit at harvest time and whether losses arising from the government's guarantee on these loans are being well managed.

**11.6** We identified limitations in how the cash advance evaluation findings were publicly reported. Similar limitations were noted in the dissemination of other studies produced by departmental branches on the impacts and effectiveness of programs. In our view, a number of characteristics of the Department, its legislation and stakeholder community create a strong case for more actively alerting outside parties to the existence and findings of effectiveness studies. Some areas of the Department are indeed taking steps in this direction.

## Introduction

**11.7** Managing cash flow is an ongoing challenge for all businesses, including agricultural producers. They incur significant up-front costs with no guarantee that a saleable product will result, and they face difficult decisions about when to sell their product in order to maximize overall returns. These decisions involve weighing a multitude of factors, including expected pricing patterns, borrowing capacity and costs, the likelihood of delivery opportunities, transportation to destination, on-farm storage capacity and others. As one farmer remarked to us during our work, "Why would I want to visit a casino? Farming is itself enough of a gamble."

**11.8** The cash advance program of Agriculture and Agri-Food Canada is one tool the government makes available to producers of storable crops to provide additional flexibility in making these marketing decisions.

### How cash advances operate

**11.9** Producers apply for cash advances through their respective producer organizations after the crop is harvested. For many producers, this is the time of year when financial obligations are at their peak. Cash advances are basically short-term loans. The harvested crop serves as the collateral for the cash advance. Typically, producers may obtain an advance for up to 50 percent of the expected selling price of their crop.

**11.10** The federal government pays the interest on the first $50,000 of an advance. The maximum advance is $250,000 but, in practice, few producers take advances beyond $50,000. For example, with respect to cash advances for prairie grain producers, only about 1,300 of the 26,700 advances made in 1997–98 were for amounts exceeding $50,000.

**11.11** Exhibit 11.1 describes the situation of a typical Prince Edward Island potato farmer during the crop year.

**11.12** Producer organizations negotiate the loans for the cash advances through local banks or other financial institutions. The largest of the producer organizations — the Canadian Wheat Board — is empowered to raise financing on its own. Because repayment of these loans is guaranteed by the Government of Canada, producer organizations are able to obtain financing at a lower rate of interest — usually below prime — than would otherwise be the case. Minimizing interest costs is important, both to the federal government, which pays the interest on the first $50,000 of an advance, and to those producers who take advances exceeding $50,000.

Producers face difficult decisions about when to sell their product in order to maximize overall returns.

### Who is involved and their roles

**11.13** The operation of the program involves the co-ordinated efforts of many groups, the most significant of which include participating producers, producer organizations, the Canadian Wheat Board, elevator companies, financial institutions, and Agriculture and Agri-Food Canada. The producer organizations play a very key role. In fact, one must exist in order for the cash advance program to be offered for a particular storable crop. These organizations perform several important administrative functions, including:

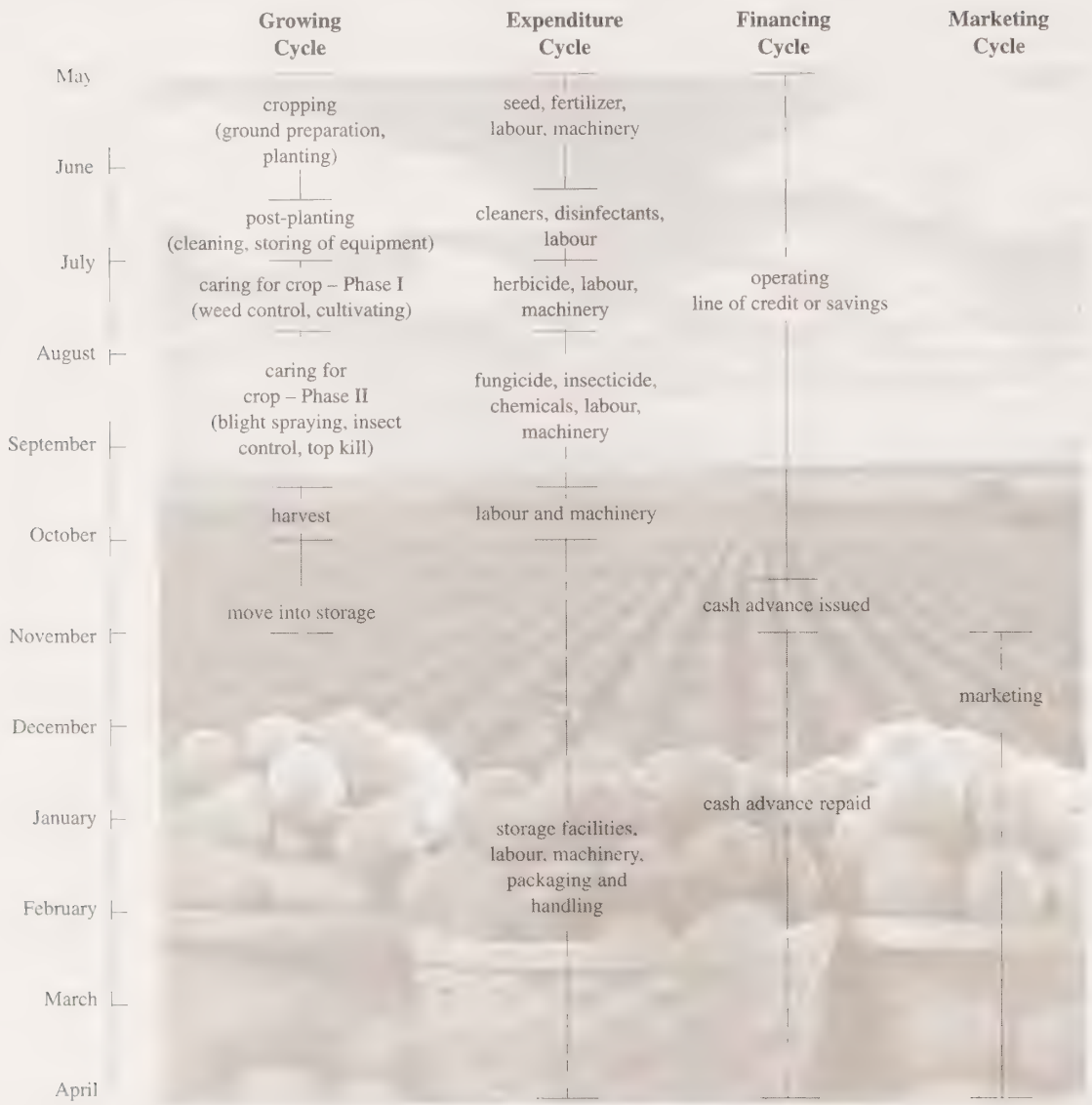
- arranging for the cash advance loans from a lender;
- negotiating a cash advance guarantee agreement with the Department;
- ensuring that the eligibility conditions are met before advances are given; and
- ensuring that the advances are repaid.

### How producers market their products

**11.14** There are essentially three ways that producers market their products; these are described in Exhibit 11.2.

**Exhibit 11.1**

**Growing, Expenditure, Financing and Marketing Cycles of a PEI Potato Producer**




By harvest time, the producers' cash demands are high. They have been making expenditures all season in order to grow their crops. In order to reduce costs and defer taxes, they may also wish to purchase inputs, such as fertilizer, for next year. However, since the crop is just coming off the field, producers have yet to earn revenue. At harvest, they have three choices for obtaining cash: selling at harvest if there is an available market; continuing to access their savings or operating line of credit; or applying for a cash advance through their producer organization. The growing, expenditure, financing and marketing cycles are illustrated above.

Based on the value and quantity of potatoes in storage, average potato producers would be entitled to an advance of $44,000 (1995–96). After deduction of a $250 administration fee payable to the PEI Potato Board, producers receive the cash advance. The advance may then be used to relieve financial pressure by paying down the operating line or by paying other outstanding bills.

As the producers sell to local potato processors or dealers, repayment of the advance will be deducted from their cheque and remitted directly to the PEI Potato Board on their behalf. If the dealer does not make deductions, the producers must make the remittance to the PEI Potato Board themselves after the sale. The advance is expected to be repaid in full by the time the producers have sold all their crop.

**The amounts guaranteed are significant**

**11.15** The value of advances guaranteed by the federal government fluctuates, depending on participation rates, product prices and product volume. Nevertheless, the total amount guaranteed is significant. In recent years, the maximum amount guaranteed has varied from $730 million to over $1.2 billion. The value of cash advances for Canadian Wheat Board grains exceeds those issued for other crops, by a large margin.

**11.16** Exhibit 11.3 demonstrates that year-to-year variation in amounts advanced can be quite large, particularly for advances made to producers of Canadian Wheat Board grains. Officials at the Canadian Wheat Board identified the following factors that account for these variations: weather conditions at harvest; quantity and quality of harvested grain; availability of early delivery opportunities; costs of production inputs; trends in grain prices; and other financial pressures.

**11.17** The manner in which prairie grains are marketed in Canada has a major impact on grain producers. In any given year, roughly 28 million tonnes of grains are produced that are marketed through the Canadian Wheat Board. However, the grain transportation system has a maximum capacity at any one time of

**Exhibit 11.2**

**Product Marketing**

| Approach of Producer Organization | Description | Examples of Producer Organizations |
|---|---|---|
| Single Desk Selling | The product is marketed and sold by the producer organization. Revenues are generally pooled and producers are paid based on the grade and quality of their product. Producers receive payments from the producer organization, after a pro rata deduction has been made to repay a portion of the advance.<br><br>In the case of the Canadian Wheat Board, elevator companies issue advances upon completion of an application by the producer. The elevator companies also pay producers a net amount at the time grain is delivered to them, after deduction of a pro rata repayment of the producers' cash advance. The Canadian Wheat Board reimburses the elevator companies for the moneys advanced and interest costs. | Canadian Wheat Board<br>BC Tree Fruits |
| The crop is sold by the producer under terms of a contract with a specific buyer | Prices are generally negotiated by producer representatives, while quantity and delivery dates are generally negotiated by individual producers. Payment is made to the producer by the contractor. Contractors often will withhold a portion of the sale price and remit this to the producer organization directly, representing repayment of the advance. | Keystone Vegetable Producers (Manitoba potatoes)<br>PEI Potato Board (process potato sector only) |
| Producers find their own customers | Customers may be elevator companies, dealers, wholesalers, processors, feed lot operators or livestock producers. Prices can fluctuate on an hourly or daily basis and may vary between similar buyers. Some buyers may withhold repayments on behalf of the producer organization, but in some cases the producer is responsible for repayment of the advance directly to the producer organization. | Canadian Canola Growers<br>Ontario Corn Producers<br>PEI Potato Board (seed and table potato sectors) |

**Source:** Discussions with producer organizations and individual producers

about 5-6 million tonnes of product. This means that farmers cannot deliver all of their grain at harvest, even if they wanted to. They must provide for on-site storage of their product until the Canadian Wheat Board is able to sell their product and arrange for shipment to the buyer.

**11.18** The government incurs three types of costs to deliver this program: interest costs on the first $50,000 advanced; the costs of making good on the principal and interest of any defaults on the funds advanced; and the costs of administering the program. The Department made a commitment to Cabinet to limit average spending on interest and administrative costs to $40 million a year over the next three years. The funding for these costs comes from the Department's "safety net" envelope of funds, the source of funding for departmental income stabilization programs.

The cash advance program has been very well received.

**11.19** Exhibit 11.4 provides general information about the size of cash advances and the financial benefits they provide for two typical groups of producers currently participating in the program. As might be expected, the interest benefit varies depending on the interest rate obtained by the producer organization, the amount of the advance and the average period the cash advance was outstanding.

**Cash advances are seen as an important sign of government support**

**11.20** The cash advance program has been very well received. Of the producers we contacted, most liked the availability and predictability of cash flow at harvest time, and the interest-free benefit. Producer organizations endorse the program because it encourages participation in their organization by producers. The program appeals to many elected officials because it has achieved a high degree of support in the agricultural community while its annual costs are seen by many as relatively low.

**11.21** In recent years, producers have been encouraged to become more market-oriented and more self-reliant. Most of the large subsidy payments of the past — including the Crow benefit, Feed Freight Assistance and other large ad hoc payments — have either been discontinued or are being phased out over time. Yet the cash advance program has

Exhibit 11.3

Cash Advances, 1992–98

| Crop Year | Cash Advances Issued for Canadian Wheat Board Grains ($ millions) | Cash Advances Issued for Other Storable Crops ($ millions) | Total Cash Advances Issued in Crop Year ($ millions) | Defaults ($ millions) | Government Interest Costs ($ millions) |
|---|---|---|---|---|---|
| 1997–98 | 533 | 237 | 770 | Not yet available | Not yet available |
| 1996–97 | 875 | 272 | 1,147 | 28.0 | 16.3 |
| 1995–96 | 542 | 212 | 754 | 7.0 | 18.3 |
| 1994–95 | 524 | 206 | 730 | 11.3 | 21.2 |
| 1993–94 | 819 | 150 | 969 | 62.6 | 13.4 |
| 1992–93 | 1,081 | 122 | 1,203 | 46.8 | 46.2 |

**Source:** Agriculture and Agri-Food Canada

survived these changing times, and today is seen by many producers as an important sign of government support to the storable crops sector.

**11.22** The program is currently provided under the authority of the *Agricultural Marketing Programs Act (AMPA),* which was passed in 1997. Although the *AMPA* refers to this as an "advance payments" program, in this report we refer to it as the cash advance program — the terminology commonly used by producers.

**11.23** Previously, two cash advance programs operated under separate authorities, the *Advance Payments for Crops Act (APCA)* and the *Prairie Grain Advance Payments Act (PGAPA).* A third authority, the Cash Flow Enhancement Program (CFEP), provided for payments under the interest-free feature of the program. In 1997 these authorities were updated and consolidated within the *AMPA,* in order to:

- eliminate inequities between the *PGAPA* and the *APCA*;
- reduce loan defaults by making producer organizations more accountable for proper administration and control over advances made to their members, including a provision that these organizations cover a percentage of any defaulted advances; and
- make permanent in legislation the interest-free provision.

From a producer's perspective, however, the basic operation of the cash advance program has remained unchanged.

### The purpose of the cash advance program

**11.24** It is important to understand what the cash advance program is intended to achieve. Exhibit 11.5 describes recently available information about the intended objectives of the cash advance program.

**11.25** Although these are somewhat different statements, the key elements seem relatively clear:

- It is a marketing program first and foremost.
- It has an objective of improving marketing opportunities.
- Improving cash flow at or after harvest is the means by which the program improves marketing opportunities.
- The government guarantee of repayment of the advance encourages lenders to provide cash advances, and these advances improve cash flow.

### Focus of the audit

**11.26** Since the legislation governing the cash advance program was recently revamped, and considering that the federal role in program administration is relatively limited, we concluded that the most significant issues were primarily related to program effectiveness. We focussed our efforts on determining whether the Department:

- had sufficient information about the effectiveness of the program;

**Exhibit 11.4**

**Cash Advance Impacts**

| | Canola | PEI Potatoes |
|---|---|---|
| Cash Advance[1] | $22,465 | $44,075 |
| Interest Paid by Government[2] | $550 | $1,675 |
| Interest Cost if Producer Must Borrow Him/Herself[3] | $825 | $2,025 |
| Administrative Fee Paid by Producer | $150 | $250 |
| Net Interest Saving to the Producer | $675 | $1775 |

**Notes:**

[1,2] Average amounts calculated using actual results for 1995–96. Interest benefit for PEI potatoes is proportionally greater than for canola because advances are usually of longer duration.

[3] Using prime (7.5% in 1995–96) + 1.25% as an average interest rate

**Source:** Agriculture and Agri-Food Canada

- had adequately disclosed what it knew of the effectiveness of the program to Parliament and other interested parties outside the Department and whether these practices were indicative of the dissemination practices used for other effectiveness studies and analyses; and

- was properly controlling financial risks to the Crown, particularly from loan defaults.

Further details on the audit are found at the end of the chapter in the section **About the Audit**.

## Observations and Recommendations

### Information on Program Effectiveness

**The Department has gathered important information about the program's effectiveness**

**11.27** The Department's Review Branch completed an evaluation of the cash advance program in 1993. The evaluation scoped in all relevant elements of the program at that time, including the *Prairie Grains Advance Payments Act,* the *Advance Payments for Crops Act* and the Cash Flow Enhancement Program. The Department's methodology incorporated several complementary lines of enquiry. These included a review of documentation, case studies and extensive fact finding with key stakeholders including producers, producer organizations, processors and processor organizations, federal and provincial government departments, and the banking community. The methodology also included an independent review of the work by a leading agricultural economist. An advisory group representing many of the program's stakeholders oversaw the study.

**11.28** We reviewed the evaluation, using procedures summarized in Exhibit 11.6.

**11.29** We concluded that there was appropriate and adequate support for the findings of the evaluation, and that these findings had been reached through the use of sound methodology. Nothing came to our attention to suggest that the evaluation findings were unreasonable or no longer relevant.

**11.30** The evaluation furnished important information about the program's effectiveness but, as in any study, some questions remain unanswered. These are discussed more fully later in this chapter.

Exhibit 11.5

Statements About the Objectives of the Cash Advance Program

**What the *Agricultural Marketing Programs (AMPA) Act* says:**

The preamble to *AMPA* describes it as "*an act to establish programs for the marketing of agricultural products . . .* ". Part I of the Act, which deals exclusively with cash advances, states, *"The purpose of this part is to improve marketing opportunities for crops of eligible producers by guaranteeing the repayment of the advances made to them as a means of improving cashflow at or after harvest."*

**What the Department's Website (ACESIS) says:**

[The cash advance program] provides cash advances with an interest-free feature on the first $50,000 to eligible producers to store eligible crops after harvest, allowing them to market the crops later in the season when the market conditions may result in better prices and thereby encouraging the orderly marketing of the crop.

**Information Provided in the 1996–97 Estimates:**

- Cash flow programs are designed to assist producers in having a more consistent and reliable cash flow from the sale of products.

**Source:** Agriculture and Agri-Food Canada

**Evaluation identified some significant concerns about the program**

**11.31** The findings of the 1993 evaluation noted that producers and their respective organizations were very satisfied with the design and delivery of the cash advance program. As well, the evaluation found clear evidence that the government guarantee leads directly to lower borrowing rates for producers.

**11.32** In a series of evaluation case studies of specific commodities, producers and producer organizations stated that the program enabled them to avoid dumping at harvest time when prices may be low, and to receive a higher and more stable price for their crops. Producers reported that the program has led to lower interest rates and improved relations with their bankers. Producer organizations believed they also have benefited from the program by being able to provide an additional value-added service to their members. Through the program, they learn more about their members' needs and increase their visibility to their membership.

**11.33** At the same time, the evaluation also raised significant questions about aspects of the program's effectiveness, notably the following:

- There was a need to articulate a policy that clearly outlines the rationale for the program.
- There was no firm evidence that the program contributes to orderly marketing, and the incremental effect is likely minimal.

**11.34** In addition, the evaluation expressed particular concern about the interest-free nature of the program, questioning the need for this feature: if the program provides producers with financing not otherwise available, allowing them to increase market returns, why would they need an interest-free incentive to participate? The evaluation suggested that the interest-free benefit serves as a form of income support.

**11.35** Exhibit 11.7 elaborates on these findings, using extracts from the evaluation report.

**Other concerns have been raised about the program**

**11.36** The 1993 evaluation is the most comprehensive study of the effectiveness of the cash advance program, but it is not the only one.

**11.37** In the mid-1980s, the Nielsen Task Force examined the two existing cash advance programs. The Task Force concluded that the Canadian Wheat Board could operate its own cash advance program, if one were needed. In the case of the *Advance Payments for Crops Act*, the Task Force concluded that the interest subsidy could be cancelled and that an advance payments program at market interest rates could achieve the same marketing objectives.

**11.38** In 1989, the government of the day decided to end the practice of paying the interest costs on the first $50,000 advanced to producers. Elimination of the interest-free benefit, although only one of several contributing factors, corresponded with a significant drop in participation in the cash advance programs in the 1989

The 1993 evaluation expressed particular concern about the interest-free nature of the program, questioning the need for this feature.

**Exhibit 11.6**

**Our Evaluation Review Procedures**

To satisfy ourselves as to the appropriateness of the 1993 evaluation findings, we reviewed the Department's methodology for conducting the evaluation and looked at the relationship between the evidence acquired and the conclusions reached.

To test the reasonableness and continued relevance of the findings, we interviewed departmental officials, representatives of producer organizations including the Canadian Wheat Board, producers (by telephone and in person, including program participants, non-participants and ex-participants), members of the Canadian Bankers Association and other financial institution staff, and those involved in the original evaluation. We also reviewed pertinent documents provided to us by the Department, and the extent to which other studies and departmental experience corroborated the findings.

crop year. Producers opposed the cancellation of the interest-free benefit and, one year later, the benefit was reinstated through the creation of the Cash Flow Enhancement Program.

**11.39** Several current and former senior officials of the Department with an intimate knowledge of the cash advance program expressed concerns to us about the program's effectiveness. We also found departmental documents that suggest that the program does not sufficiently meet the six tests set out in the government's recent Program Review exercise: serving the public interest; necessity for government involvement; appropriate federal role; scope for public sector/private sector partnership; scope for increased efficiency; and affordability.

**11.40** Given that the Department had important information about the program's effectiveness, and that the program was not significantly altered in the revamping of the legislation, we examined what the Department did to:

- clarify the program's objectives and rationale, as the evaluation had recommended; and
- make effectiveness information available to parliamentarians and others

Exhibit 11.7

**Key Extracts from the 1993 Evaluation**

**Relating to Improved Marketing Opportunities**

"Analysis of the effect of the *Advance Payments for Crops Act* on prices was inconclusive, confounded by other factors and restricted by the limited participation in the program."

"The evaluation found no firm evidence that these programs contribute to orderly marketing. However, . . . it is likely that more orderly marketing occurs with these programs than would occur without them, even though the incremental effect is probably minimal."

**Relating to Increased Cash Flow**

"The *Prairie Grains Advance Payments Act* serves producers by alleviating cash flow problems caused by the lack of delivery opportunities as a result of limited quotas or transportation handling constraints."

"The program allows the Canadian Wheat Board to extend advances at a very favourable interest rate."

**Relating to the Interest-Free Benefit**

"A distinction needs to be made between advance payments — the tool for cash flow enhancement and orderly marketing — and the interest-free benefit of the program, which provides income support."

"Analysis showed that there is little economic justification for making advances interest-free — there is no evidence that there is a need for the Cash Flow Enhancement Program (CFEP) (i.e. the interest-free benefit) or that it actually promotes orderly marketing — except that the effect of CFEP in making advances interest-free serves as an incentive for participation in advance payment programs."

"If participation in advance payments is dependent on the availability of the [interest-free benefit], this suggests that producers see little need for advance payments in themselves."

"Evaluation interviews also suggested that there would be drastically reduced participation in the programs unless the cash advances are interest-free or have a substantial interest rate benefit. This argument suggests that either:

- farmers have sufficient resources of their own to carry the crop or they can obtain financing at acceptable rates from commercial sources — that is, there is no cash flow problem; or
- the benefit of holding the crop is, at best, little more than the interest cost — that is, the net increase in revenue is so small that if interest costs must be paid, there is no incentive to hold the crop.

In either case, the need for government subsidized advance payment programs is questionable."

**Source:** Agriculture and Agri-Food Canada – Executive Report: Evaluation of the Advance Payments Program (1993)

outside the Department with an interest in the program's effectiveness.

**Program's rationale was not sufficiently clarified**

**11.41** The first recommendation of the 1993 evaluation emphasized the need to develop a clear policy rationale for the cash advance program — one that distinguished between marketing, cash flow and income support objectives. In its response to the evaluation report, the Department made a commitment to clarify the program's rationale during the legislative review.

**11.42** As noted earlier, the overall objective of the program as set out in the *Agricultural Marketing Programs Act* is relatively clear. However, the government has not made clear why advances are provided interest-free. This is despite the evaluation's finding that a clear articulation of the policy rationale for this part of the program was needed, which was also the conclusion of a 1993 departmental internal audit of the Cash Flow Enhancement Program. This is significant because making the interest-free benefit a permanent feature of the program was a driving force behind the new legislation.

**11.43** The only public indication we could find of a possible intent of the interest-free benefit was contained in the 1993 election platform of the government. It suggested that the intended purpose of the program was to reduce interest costs as a way of offsetting the rising costs of farm inputs. This view of the program is similar to that of the 1993 evaluation, which saw the interest-free benefit as a form of income support. Some departmental officials told us that they do not consider the interest-free component to be intended as income support. However, officials were unable to provide any public or internal statement of the intent of this provision.

**11.44** It is important for the Department to clarify the objectives for this aspect of the cash advance program because it is a prerequisite to evaluating its effectiveness. Arguments can be made both for and against the interest-free aspect of the program, but without a clear idea of what it is meant to accomplish, meaningful debate about its merits is hampered.

**11.45** Although the recommendation of the evaluation to develop a clear policy rationale for the program was not entirely implemented, we noted that, in revamping the legislation, the Department did act on other key recommendations of the evaluation.

The government has not made clear why advances are provided interest-free.

## Public Reporting of Departmental Effectiveness Studies

**This case illustrates limitations of public reporting of departmental effectiveness studies**

**11.46** The Department included a summary of the evaluation findings in the 1994–95 Estimates Part III, reproduced in Exhibit 11.8. This practice complies with Treasury Board requirements. It was the only public reporting of the existence of the evaluation and its findings.

**11.47** The case of the cash advance program illustrates why these summaries, although useful, ought to be augmented by

Exhibit 11.8

**Summary of the 1993 Evaluation Study in the 1994–95 Estimates Part III**

The evaluation found that there is strong support from stakeholders for the continuation of the programs, and producers' motivation for participation is primarily cash flow. The evaluation also showed that the programs are potentially effective in promoting orderly marketing, but that the means used by the programs, for example, cash flow assistance and income support, have become confused with the underlying goal of orderly marketing. It was also noted that there is a need for a clear articulation of the policy rationale for the programs, as well as a need for modifications to the programs to link them more closely to their marketing objectives and make them more responsive to producers' needs.

**Source:** 1994–95 Estimates Part III

other means of alerting those outside the Department to the existence and findings of evaluations:

- There are many topics covered in Estimates documents, so summaries are necessarily short and high-level. They cannot be expected to provide full information about all significant aspects of program effectiveness. In this case, the summary does not mention some of the key findings outlined in Exhibit 11.7 — particularly the issues raised about the interest-free nature of the program.

- The Estimates summaries alert parliamentarians and stakeholders to the existence of an evaluation, and give an overview of the findings, so that parliamentarians, their staff and others can request further information or a copy of the study. But in this case, by the time the new legislation was before the House, more than three years had passed since the summary had been published. As documents of record, the Estimates are available for searching electronically and in hardcopy. However, this span of time increases the chances that parliamentarians, their staff and committee researchers might not have been aware of the existence of the evaluation during the course of deliberations on the legislation.

The Estimates summary was the only public reporting of the existence of the evaluation and its findings.

**11.48 Strong arguments exist for more actively disseminating departmental effectiveness studies.** We believe that there are a number of characteristics of the Department, the legislation it is responsible for administering and the nature of its stakeholder community that together create a strong case for more actively publicizing the existence and findings of departmental evaluations and other studies of the effectiveness of agricultural programs:

- There is an extensive network of agricultural producer and industry groups interested in the effectiveness of agricultural programs, along with a relatively large community of agricultural economists who research the effects of agricultural programs. These groups and others engage in active public debate about the merits of various agricultural programs.

- The Department is in a unique position to contribute to debate on the impacts of agricultural programs, recognizing that information on program effectiveness improves the quality of public debate by providing a factual basis for debate between program proponents and opponents. For example, the Department has access to considerable administrative data that are invaluable in such studies. Indeed, the Department produces numerous studies on the impacts of agricultural programs, particularly in its Policy Branch, which is one of the largest policy branches in the federal government.

- Many departmental programs have sunset provisions or built-in five-year review requirements creating opportunities for debate on the effectiveness of these programs.

- The Department conducts extensive consultations on the future direction of its programs, for which information on actual program impacts may modify or strengthen the views of those consulted.

For these reasons, we believe that the Department ought to augment its dissemination efforts in two key ways.

**11.49 Better information dissemination at the time of parliamentary reviews and stakeholder consultations.** First, at the time of legislative reviews by Parliament (for example, when legislation is revamped as with the cash advance program, or when parliamentarians are examining the results of five-year reviews of agricultural programs), we believe that the Department should inform parliamentarians of effectiveness information it has obtained about the program in question. This can

come from evaluations, other studies or ongoing performance measurement. The Department ought to offer to provide briefings and supporting documents about this information to parliamentarians and staff. Parliamentarians have repeatedly said that they are interested in receiving evaluation information, a view confirmed in the April 1997 Sixty-Fourth ("Catterall") Report of the Standing Committee on Procedure and House Affairs.

**11.50** Similarly, we believe that the value of departmental consultations would be enhanced by providing those consulted with information on what is known about program effectiveness. The Department often undertakes consultations with stakeholders concerning the future direction of agricultural programs. In the case of the cash advance program, a very comprehensive series of consultations were held before the legislation was revamped. Those consulted were provided with extensive material outlining a number of possible options for the program. We believe that, in future consultations, augmenting such information with what is known about the program's effectiveness would enhance the value of the consultation process.

**11.51 In future parliamentary reviews and consultations with stakeholders on agricultural programs, the Department should provide briefings and supporting documents on program rationale and objectives, and on what is known about the program's effectiveness.**

***Department's response:*** *The Department routinely provides stakeholders and the Standing Committee on Agriculture and Agri-Food with briefings and other sources of information that speak to questions of program rationale, objectives and effectiveness. For example, as part of the recent national safety net review consultations, Industry Advisory Committee members were provided with exclusive Internet access to all available departmental analysis of safety net programs. In all of its external communications and consultations, the Department strives to meet the information needs of parliamentarians and industry stakeholders while respecting legitimate international trade considerations, federal-provincial relations and Cabinet direction.*

*In the case of advance payments, the 1993 evaluation was a catalyst that ultimately led the Department to embark on a comprehensive and, according to several industry leaders, effective national consultation process on options for reform. Although the evaluation itself was not distributed, the Department's discussions with stakeholders were informed by its main findings/ recommendations as well as a number of other information sources and other legitimate factors. One such factor was the 1995 Budget statement that, in keeping with a 1993 promise to the Canadian people, committed the government to bringing the interest-free feature of advance payments into legislative force.*

*The Department is committed to improving its formal parliamentary reporting practices, including the five-year review required under the* Agriculture Marketing Programs Act. *This commitment is evident in the Department's voluntary participation in the Improved Reporting to Parliament Project and in its ongoing implementation of a business line, results-based approach to managing and reporting.*

**11.52 Better ongoing dissemination of effectiveness information.** Second, we concluded that the Department ought to be more proactive in disseminating evaluations and other studies of agricultural program impacts as they are completed. A number of concerned stakeholders told us that in recent years the Department has not been forthcoming in making these studies public.

A number of concerned stakeholders told us that in recent years the Department has not been forthcoming in making public its studies of agricultural program impacts.

**11.53** As Exhibit 11.9 notes, we found two areas in the Department that had not been systematically disseminating studies but that have recently taken steps to make analyses and effectiveness studies available to interested parties outside the Department. These initiatives represent a promising new orientation toward openness.

**11.54** The initiatives of both Directorates are in their infancy and, therefore, it is too early to draw definitive conclusions on their impact, or on whether they will effectively address stakeholders' concerns. As well, these initiatives have been limited to those two areas. Studies on the impacts and effectiveness of departmental programs are undertaken elsewhere in Policy Branch, in the Review Branch and by program management.

**11.55** Review groups in a number of other departments have taken proactive steps to alert outsiders to the existence and findings of effectiveness studies; for example, some groups have made entire evaluation reports or their executive summaries available on departmental websites or on a Treasury Board Internet data base of evaluations and reviews. As in the case of the evaluation of cash advances, the Department publicly reports effectiveness studies in a one- or two-paragraph summary in departmental Performance Reports in the Estimates, without references to how more detailed information can be obtained by those interested. This same summary is the extent of the information that the Department provides on the Treasury Board Internet data base. Adopting the practices of these other departments could enhance the ease of access by outside parties to the findings of departmental effectiveness studies.

**11.56** Other inexpensive means are available that would increase the likelihood of interested stakeholders becoming aware of effectiveness studies and would make access to these studies easier for those interested in more detailed information. For example, it would be a relatively simple matter to create a list of interested stakeholders (as the Economic and Policy Analysis Directorate has done) and alert these stakeholders by mail, facsimile or e-mail when particular effectiveness studies have been completed. As a further example, the studies could be included in the catalogue of publications available to the public

Exhibit 11.9

Two Areas Where Dissemination Practices Have Improved

**Economic and Policy Analysis Directorate**

This group undertakes a significant amount of analytical work each year. Although some of it is focussed on providing direct support to policy analyses done on behalf of the Minister, it performs a significant amount of analysis that is less confidential and of potential interest to academics, industry, producer organizations and other stakeholders.

Until recently, the Directorate did not systematically disseminate its studies and analyses outside the Department. The Directorate has recently made a deliberate effort to establish a list of key stakeholders that are interested in their work. Further, it distributed a medium-term business plan to more than 700 of these stakeholders, outlining the studies the Directorate intends to undertake over the next three years. The Directorate now has the authority to release on its own a defined set of analyses. This is designed to encourage faster, more timely release of completed studies.

Furthermore, the Directorate is making access to approved studies more user-friendly than has been the case in the past, including providing access to studies through the Internet.

**Farm Income Policy Directorate**

For the negotiations currently under way with provinces and other stakeholders regarding the next generation of safety net programs coming on stream in 1999, this Directorate is making available to its partners recent studies, analyses and discussion papers prepared by the Department. In the past, distribution of this type of information was much more restricted.

**Source:** Agriculture and Agri-Food Canada

from the departmental Publications Service.

**11.57** Again, the Department's existing practices meet the specific requirements of Treasury Board policy. However, the additional steps noted above represent practices that are consistent with the Treasury Board policy's thrust toward making reports readily accessible to the public, and already are being initiated in two areas of the Department.

**11.58 The Department should implement practices to better alert interested stakeholders of the existence and findings of evaluations, ongoing performance measures, and other studies of program impacts. These practices should include:**

- **providing information on how more detailed information can be obtained (in addition to the summary of study findings in departmental Estimates documents);**
- **publicizing the list of completed studies;**
- **developing and maintaining a list of interested stakeholders and notifying stakeholders about completed studies; and**
- **examining the feasibility of additional vehicles to disseminate information, including the Internet.**

***Department's response:*** *As the audit notes, the Department's current dissemination practices comply with the Treasury Board Policy on Review. Nevertheless, the Department is committed to finding new and better ways to serve the emerging information needs of its clients.*

*Over the coming months, the Department will be consulting with its stakeholders in order to gain a better appreciation of those information needs, expectations and dissemination preferences. The above-noted suggestions for improvement will be implemented to the extent that they are consistent with stakeholder interest in receiving evaluations, audits and program impact studies conducted by the Department.*

## Information on Cash Advances Is Needed for the Future

**11.59** In the new *Agricultural Marketing Programs Act*, Parliament reaffirmed its belief that periodic reviews of programs are an important tool for oversight. A provision was incorporated in the Act requiring, "During the fifth year after this Act is assented to, the Minister must review the provisions and operation of this Act in consultation with the Minister of Finance." The fifth year of operation will begin in 2001.

In the new *Agricultural Marketing Programs Act*, Parliament reaffirmed its belief that periodic reviews of programs are an important tool for oversight.

**11.60** The 1993 evaluation provided important information about the program's effectiveness but, as with any study, some questions remain unanswered. We believe the Department needs to begin to develop an appropriate framework for this review and to identify the types of data it will need to complete the review. This would help ensure that the information required is available when needed. At the time our audit was being completed, departmental officials informed us that work was beginning in the Review Branch on an evaluation framework of the program in preparation for the five-year review.

**11.61** In addition to clarifying the rationale for the program, as discussed earlier, there are a number of questions that the Department ought to explicitly address in the five-year review, if not earlier.

### Do cash advances provide producers with additional credit availability?

**11.62** The extent to which the cash advance program gives loans to producers that would not otherwise be available is key to the program's effectiveness. If it does serve this purpose, it would represent a significant benefit to producers. If it

does not, then the value of the program in improving marketing opportunities would be questionable, since producers could use other financing to allow them to market crops later in the season.

**11.63** The 1993 evaluation did not address this issue in depth. It did, however, raise important questions about the matter. Noting that participation would likely be "drastically reduced" without the interest benefit, the evaluators suggested that either producers already have adequate financing available, or that increased returns from delayed marketing do not cover the cost of interest. The Department was unable to provide us with any other studies or analyses about whether there is indeed an "access to credit" problem at harvest time.

## Is there an "access to credit" problem at harvest time?

**11.64** We believe that there is a need to examine this issue more comprehensively in time for the five-year review, both because of questions raised in the evaluation and because of statements made to us by producers and banking officials during our work.

**11.65** One aspect of this issue is whether those who already have access to credit from existing sources can obtain an increased amount by virtue of this program. Many producers use operating lines of credit to finance their input costs until the crop can be sold. Operating lines of credit are secured in whole or in part by the value of the producer's crop. When a cash advance is obtained, the financial institution is required to give the federal government priority over the bank's claim to this collateral. As a result, the collateral is no longer available to secure the operating line of credit. Producers and banking officials told us that if producers have fully used their available operating line and then obtain a cash advance, the bank generally requires the producer to reduce the operating line by using a portion of the cash advance. If the bank does not reduce the operating line, then this indicates that the bank would have been willing to increase the operating line by at least the amount of the advance, had the producer asked.

**11.66** In other words, if these reports are correct, the program may not be increasing the credit available to producers with operating lines. Selected remarks by producers are found in Exhibit 11.10.

**11.67** It is also important to note that this program is not intended to finance producers who are poor credit risks. Indeed, the Department expects producer organizations to carry out credit checks on all producers before issuing advances. The program also requires producer organizations to cover a portion of defaults to help ensure that they do not take excessive credit risks.

**11.68** It would be inappropriate to conclude from this limited evidence that the program does not provide additional financing to producers. These statements, however, do raise questions that suggest the need for a systematic analysis of actual participant financing experience to establish whether there is indeed a significant problem of access to credit at harvest time and whether the program provides significant additional financing to producers. Ongoing data needed for such a study could be collected when producers apply for an advance. The study could also examine how financing availability may vary over time. The last few years have been characterized by a relatively buoyant economy, and there is a feeling that credit availability declines in

**Exhibit 11.10**

**Producers' Remarks Made During Audit Interviews**

"One of the disadvantages of the program is that the bank will limit your operating line."

"If you are at your limit on your operating line, in effect your advance comes to you already made payable to the bank."

"The interest-free benefit attracts me to participate. If this were removed, I'd shop around for the cheapest financing."

"Financing is financing. If the cash advance program wasn't free, I'd just keep going to my bank."

more difficult times. As well, interest rates have been low recently. If interest costs reach higher levels, credit may be available but less affordable to producers.

**Does the program contribute to improved marketing opportunities?**

**11.69** Although the 1993 evaluation was unable to obtain hard evidence linking the cash advance program to improved returns to producers, it did note that most stakeholders and organizations are convinced that it does improve returns. Interviews we held with stakeholders suggest that this viewpoint is still widely held.

**11.70** Given that the stated objective of the cash advance program is to improve marketing opportunities, we believe the Department needs to gather the appropriate data to demonstrate whether or not that is occurring, in time for the coming five-year review. We also believe that the Department could gather information that would shed light on this matter at a reasonable cost. A collaborative effort over several years may be necessary in order to ensure that sales history and related data necessary to address this issue are available.

**11.71** An important aspect of this question is whether, beyond any benefits to individual producers, there are broader benefits to the market prices received by all producers because of the program. Some producers contend that dumping by even a small number of producers at harvest time can have a detrimental effect on prices for the entire season. If this is true, then providing some financial incentive to encourage program participation may well have a clear policy rationale.

**Is the payback for producers better elsewhere?**

**11.72** The cost effectiveness of the cash advance program needs to be compared with that of other safety net programs. Because the safety net expenditures are capped, producers benefit if the money is spent on programming that provides the greatest cost effectiveness. This is especially relevant if the purpose of the interest benefit of the cash advance program is income support, as the 1993 evaluation suggested.

**11.73** For the same reason, the program needs to be evaluated in comparison with other agricultural programs. In recent years, the Department and others have conducted studies that argue that returns on public expenditures strongly favour investments in productivity and growth-enhancing measures such as crop research and product/process development, with benefit-cost ratios many times that of income support programs.

**11.74** As well, it may be that a more cost-effective program could be designed. When the administrative costs incurred by producer organizations, the Canadian Wheat Board and elevator companies are added to that of the federal government, the total annual cost of program administration is likely upward of $5 million. These administrative costs might be reduced or better utilized under other program alternatives. For example, if it is determined that the program does not significantly increase the availability of credit, other program delivery options — such as paying a benefit directly to eligible producers — could provide interest rate relief while crops are in storage. This could avoid the administrative cost of providing a financing mechanism already available from financial institutions, and avoid the costs incurred on defaults. Such options ought to be examined as part of the five-year review.

**Is the Department managing losses well?**

**11.75** A major impetus behind the recent revamping of the legislation and consolidation within the *Agricultural*

The cost effectiveness of the cash advance program needs to be compared with that of other safety net programs.

The Department together with the Canadian Wheat Board took action to reduce the level of defaults.

*Marketing Programs Act* was the desire to reduce losses due to defaults, that is, the amounts paid by the government to financial institutions for cash advances that have not been repaid. In the mid-1990s, the level of defaults, especially relating to the Prairie Grains Advance Payments program, threatened to undermine the viability of the entire cash advance program. When it became apparent that losses were becoming unacceptably high, the Department together with the Canadian Wheat Board took action to try to reduce the level of defaults. The changes they introduced to administrative practices contributed to reducing loan defaults from their peak of $61.6 million in 1993–94. Exhibit 11.11 provides a recent history of defaults attributable to both Canadian Wheat Board grains and other crops.

**11.76** The new *AMPA* legislation puts more onus on producer organizations to ensure that cash advances are made only to eligible producers. The government guarantee is effective only if the advances are properly administered. Producer organizations are now responsible for between 1 and 15 percent of the costs of any defaulted advances, with the percentage depending on the organization's historical loss experience. Once the government pays a default, it continues efforts to seek repayment from the producer.

**11.77** Although Exhibit 11.11 indicates that defaults have improved in recent years, and the Department believes that its recent default performance is acceptable, it has no real basis for concluding so because it lacks any objectively determined benchmarks. For the same reason, we were unable to determine if the Department was managing defaults sufficiently well. It does not have adequate information in the following two important areas and, accordingly, is not able to draw conclusions about how well it is managing defaults.

- The Department has no rational basis for predicting what ultimate losses are likely to be. It currently manages defaults more than it manages losses (the ultimate cost of these defaults, after the Department has exhausted collection avenues). Having reliable information on estimated losses is important for putting defaults in perspective.

- The Department has no meaningful performance targets for program losses, but it could develop some easily using the commercial banks for benchmarking purposes. Bank operating lines of credit are secured by the same collateral as cash advances, and the cash advance program is not intended to give money to poor credit risks. Therefore, it is reasonable to conclude that agricultural loan loss targets for the commercial banks would be an appropriate starting point for determining an appropriate departmental target.

**11.78** A recent Treasury Board submission by the Department illustrates the need for this information. The Department has decided to assume collection responsibility for all defaults relating to advances made through the Canadian Wheat Board. The Department estimated it would collect at least $40 million of more than $90 million in outstanding defaults under the *Prairie Grains Advance Payments Act* — but it had no objective data on which to base this prediction. Most of these defaults are now four to five years old, and are still outstanding despite existing set-off opportunities and other collection efforts that have already taken place. This estimate was basically nothing more than an educated guess. In reality, the feasibility of collecting such a large

Exhibit 11.11

Recent Default Performance ($ millions)

| Year | CWB Grains | Other |
|---|---|---|
| 1996–97 | 26.1 | 1.9 |
| 1995–96 | 5.9 | 1.1 |
| 1994–95 | 10.5 | 0.8 |
| 1993–94 | 61.6 | 1.0 |
| 1992–93 | 45.5 | 1.3 |

**Source:** Agriculture and Agri-Food Canada, Canadian Wheat Board

proportion of an aging debt is open to question. Indeed, departmental officials informed us that they no longer consider this to be an achievable target.

**11.79** Developing appropriate information and performance indicators, as noted above, would assist the Department to assess how well it is managing losses, and demonstrate this in time for the five-year review.

**11.80 In preparing for the five-year review of the cash advance program under the *Agricultural Marketing Programs Act*, the Department should:**

- **further clarify the policy framework that explains why the cash advance program exists and what it is intended to achieve;**
- **develop a review framework and identify the data and other information needed to examine the program's effectiveness in the five-year review; and**
- **complete the examination of the program's effectiveness and provide the findings to parliamentarians and departmental stakeholders.**

***Department's response:*** *The auditors are aware that program management is already working with the Department's Review Branch to develop an evaluation framework and to identify information that should be collected in order to ensure proper analysis, performance measurement and reporting.*

**11.81 The Department should identify a set of suitable performance measures for the cash advance program, including measures for loan loss management.**

***Department's response:*** *This is being done through the development of the above-mentioned evaluation framework and performance measures.*

## Conclusion

**11.82** The cash advance program is well regarded by producers. Many of the large agricultural assistance programs of the past have ended, and producers see this program as an important sign of continuing government support for the sector.

**11.83** Work done by Agriculture and Agri-Food Canada in 1993 to look at the program's effectiveness reached some positive conclusions about the program, but also raised some significant concerns, particularly with the interest-free nature of the program.

**The Department has no meaningful performance targets for program losses.**

**11.84** Under the *Agricultural Marketing Programs Act* passed in 1997, a review of the provisions and operations of the Act must be completed in the fifth year of operation, which begins in 2001. The 1993 evaluation furnished important information about the program's effectiveness. However, as in any study, some questions remain unanswered, the answers to which are necessary for the Department to have sufficient information about the program's effectiveness.

**11.85** The Department still needs to clarify the reason why advances are provided interest free. The Department also needs to establish benchmarks, without which neither management nor our audit could conclude whether loan losses are being properly managed.

**11.86** It is important to be realistic about the role that evaluations and other forms of effectiveness information can play. They have a role within the internal management of government, providing advice on how policy and programs can be improved. They also have a role in informing parliamentarians, stakeholders and the public about the effectiveness of government programs. As noted in Matters of Special Importance in the 1996 Report of the Auditor General, effectiveness information does not replace judgments on the value of programs, but it

allows these value judgments to be based on better facts and arguments. It enlightens — not ends — debate on the issues of the day.

**11.87** We identified limitations in how the cash advance evaluation findings were publicly reported. Similar limitations were noted in the dissemination of other studies produced by departmental branches on the impacts and effectiveness of programs. In our view, a number of characteristics of the Department, its legislation and stakeholder community create a strong case for more actively alerting outside parties to the existence and findings of effectiveness studies. Some areas of the Department are taking steps in this direction.

# About the Audit

## Objectives

The legislation governing the cash advance program was recently revamped and also requires a five-year review of the program. Given these circumstances and since the federal role in the program's administration is relatively limited, we concluded that the most significant issues were primarily related to program effectiveness. We specifically asked whether the Department:

- had sufficient information about the effectiveness of the program;
- had adequately disclosed what it knew of the effectiveness of the program to Parliament and other interested parties outside the Department and whether these practices were indicative of the dissemination practices used for other effectiveness studies and analyses; and
- was properly controlling financial risks to the Crown, particularly from loan defaults.

## Scope

Our audit focussed on the *Advance Payments for Crops Act (APCA)*, the *Prairie Grain Advance Payments Act (PGAPA)* and the Cash Flow Enhancement Program (CFEP). In 1997 these authorities were updated and consolidated within the new *Agricultural Marketing Programs Act (AMPA)*.

We examined audit and evaluation reports completed by the Department, in particular focussing on an evaluation completed by the Review Branch in 1993. We conducted in-person and telephone interviews with a number of producer organizations, including the Canadian Wheat Board, as well as individual producers, financial institutions and officials from Agriculture and Agri-Food Canada. Further details about our approach are explained in Exhibit 11.6.

We examined the dissemination practices used for other departmental effectiveness studies, and selected practices in other federal departments.

Finally, we examined departmental practices for managing program loan losses and defaults.

## Criteria

We expected the Department to:

- develop clear objectives, measures and a data collection methodology to allow for evaluations of the program;
- respond to and take action on the recommendations in the evaluations;
- share the results of evaluations of the program with parliamentarians and stakeholders;
- share relevant information from all evaluations and other effectiveness studies with affected parties; and
- properly control financial risks to the Crown.

**Audit Team**

Assistant Auditor General: Don Young
Principal: Neil Maxwell

Linda Anglin
John Rossetti

For information, please contact Neil Maxwell.

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# Report of the Auditor General of Canada to the House of Commons

## Chapter 12
Creation of the Canadian Food Inspection Agency

**September 1998**

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to the House of Commons

**Chapter 12**

Creation of the Canadian Food Inspection Agency

**September 1998**

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# Chapter 12

## Creation of the Canadian Food Inspection Agency



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# Creation of the Canadian Food Inspection Agency

## Main Points

**12.1** The federal government is considering the use of alternative service delivery (ASD) arrangements in order to improve service delivery. The Canadian Food Inspection Agency (CFIA) was the government's first legislated service agency; it was created as a departmental corporation and became operational 1 April 1997. Its primary responsibility is to contribute to food safety, plant and animal health as well as to facilitate trade in all areas by providing inspection and related services.

**12.2** There was a clear rationale for creating the Agency, including a 30-year history of studies related to reorganizing the federal food inspection system and the government's commitment to a new and better way of delivering services. Senior officials of the three federal departments then involved in food safety inspection supported the initiative to create a single food inspection service. This initiative illustrated that change can be best introduced and sustained when there is a clear rationale that has the support of senior officials.

**12.3** The designation of a structured and independent team was crucial to managing the move to agency status. The team's work was separate from the ongoing business of inspections and quarantine activities, so those services could continue without interruption throughout the creation of the CFIA.

**12.4** One of the driving forces behind the move to ASD arrangements is their greater flexibility in human resource management. With the move outside the *Public Service Employment Act* and the change to separate employer status, the shift to a new human resources regime was one of the Agency's greatest challenges. The complexities entailed in creating a new human resource framework as a separate employer need to be recognized and planned for early in the change process.

**12.5** In an area of shared responsibility such as food safety, roles need to be carefully defined and mechanisms established to resolve unanticipated problems. The establishment of an accountability framework was a key concern during the creation of the CFIA. Specific responsibilities for food safety were assigned to the Minister of Agriculture and the Minister of Health. Some operational details were still being worked out as new issues arose during the first year of operations.

## Introduction

**12.6** Since the early 1990s, the government has recognized the need in the public service for greater flexibility, innovation and focus on results. Pressures for change have included the size of both the deficit and the debt, as well as changing public perceptions and expectations about the role and performance of government. Faced with these pressures, the government has been reviewing the programs it delivers. In the process, it has been considering where alternative service delivery (ASD) approaches might be more conducive to efficiency and effectiveness than traditional delivery through departments and, at the same time, more responsive to the needs of Canadians.

**12.7** It has used commercialization, for example, to transfer services from the public sector to the private sector, as it did in the sale of the air navigation system to NAV CANADA. The government also uses arrangements with partners outside government, such as private enterprise, community groups and non-governmental organizations. And it is making more use of partnering arrangements with other levels of government; an example is the arrangement with provinces to deliver labour market training. Government has established special operating agencies, such as the Passport Office. In addition, new service agencies are being created: the Canadian Food Inspection Agency (CFIA) is one, and there is legislation pending to establish a Canadian Parks Agency and a Canada Customs and Revenue Agency.

**12.8** The government has decided that proposals to establish alternative service delivery agencies would be examined individually, and on a business case basis. The CFIA was the first major service agency legislatively established by the federal government in a very important area, Canadian food inspection and quarantine activities. There is an interest, including within the CFIA itself, in understanding what was learned during the CFIA's establishment and how these lessons can be used by the government as it continues to promote new governance structures through transformations of government programs to alternative service delivery mechanisms.

## The Canadian Food Inspection Agency

**12.9** The CFIA was established in 1997 by the *Canadian Food Inspection Agency Act*. It is a departmental corporation with separate employer status, listed in the *Financial Administration Act* (Schedule II). Its primary responsibility is to enforce standards described in legislation pertaining to food safety and to animal and plant health. It does this by providing inspection services such as registration of processing plants, inspection of domestic and imported foods, certification of exports, and quarantine.

**12.10** The Agency is headquartered in Ottawa. It operates programs in all 10 provinces and the territories. The CFIA is moving to a regional structure with four centres of operations and 18 regions across the country. It has about 4,200 staff in 26 area offices, 185 field offices, 408 third-party establishments (such as slaughter establishments) and 22 laboratories and research facilities.

**12.11** Prior to the creation of the CFIA, inspection and related services for food safety and animal and plant health were provided by Agriculture and Agri-Food Canada, Health Canada and the Department of Fisheries and Oceans. These three departments transferred about $330 million and 4,500 full-time staff equivalents (FTEs) when the Agency was created. Of the total transfer, Agriculture and Agri-Food Canada contributed over 86 percent, Health Canada just over 3 percent, and the Department of Fisheries and Oceans about 9 percent. Exhibit 12.1 outlines the benefits expected from the

transfer of these services to a single agency.

**Management and accountability framework**

The CFIA has the flexibility to replace some traditional departmental approaches in managing its mandate.

**12.12** In keeping with the ASD approach, the CFIA has the flexibility to replace some traditional departmental approaches in managing its mandate.

**12.13** **Human resources.** The legislation created the Agency as a separate employer under the *Public Service Staff Relations Act* (Schedule I, Part II). Separate employers are part of the federal public service and the employees are still public servants, paid from public funds.

**12.14** Separate employers are delegated the authority traditionally assigned to the Treasury Board Secretariat to negotiate collective agreements directly with the unions and establish terms and conditions of employment. In consultation with others, the Agency determines its own compensation and classification systems and work force adjustment and travel policies, among others. It works with unions to explore flexibilities in areas related to terms and conditions of work to better meet industry demands.

**12.15** During the first year of operations, the Agency remained under the *Public Service Employment Act*. On 1 April 1998, it became legally responsible for establishing its own staffing regime, which had the legal effect of moving it out from under the *Public Service Employment Act* and the staffing regime of the Public Service Commission.

**12.16** **Finance.** Most government departments are funded annually through parliamentary appropriations. The Agency has the authority to spend its annual appropriations over 24 months rather than the traditional 12-month period. It has the authority to spend revenues it has generated (user fees), which represent about 12 percent of its budget.

**12.17** **Accountability.** The accountability regime is a mix of new and traditional approaches to governance. The Agency's regime retains the principles of parliamentary accountability and ministerial responsibility. Two ministers are responsible for implementing the federal food safety program. The Minister of Agriculture is responsible for inspection activities; the Minister of Health sets food safety policies and standards in the area of human health, and assesses the effectiveness of the Agency's related activities.

**12.18** The Agency's management authorities are assigned to the President, who is appointed by the Governor in Council for a term not to exceed five years; the appointment may be renewed

Exhibit 12.1

**Expected Benefits of the Agency**

Through a more effective, streamlined approach to food inspection and animal and plant health services, the CFIA is expected to enhance consumer protection and work closely with clients to increase market access for Canada's food and agricultural products.

**The Agency:**

- improves service delivery by providing a single contact for consumer and food industry clients' federal food inspection requirements;
- reduces overlap and duplication of services;
- enhances efficiency in the delivery of federal food inspection;
- supports a safe food supply through the use of science-based inspection programs;
- continues and enhances access to international markets for Canadian producers and processors;
- sets the stage for a national food inspection system.

**Source:** CFIA, Corporate Business Plan 1997–2000

for one or more terms. Under the Act, the President is accountable for "supervision over and direction of its work and staff", while the Minister of Agriculture is responsible for the "overall direction of the Agency". The President submits to the Minister the Agency's corporate business plan and annual report, which the Minister tables in Parliament.

**12.19** The corporate business plan must be prepared at least once every five years. It is to include the Agency's objectives, strategies, expected performance and budget information. The annual report must include audited financial statements, performance information against the objectives established in the corporate business plan, and an assessment by the Auditor General of Canada as to whether the performance information is presented fairly and is reliable.

## Focus of Our Study

**12.20** The focus of this study was to describe the reorganization of the federal food inspection system and the Agency's progress during its first year of operations. In addition, the study identified a number of useful practices that were employed, and other practices to consider in establishing ASD arrangements.

**12.21** Throughout the chapter, we frequently conclude our findings with a *useful practice* or a *practice to consider*. *Useful practices* are those that seem to have worked for the CFIA and that could be considered in other ASD arrangements, taking into account the specific circumstances of each case. *Practices to consider* are those that might have addressed some identified concerns but were not used in the CFIA case, or were used only to a limited extent. We suggest that they be considered by others involved in a similar move to agency status.

**12.22** Further details on the study are found at the end of the chapter in the section **About the Study**.

# Study Findings

## Key Factors in the Agency's Successful Creation

### Rationale and support

**12.23** **Long history of identifying reasons to reform the food inspection system.** More effective delivery of food inspection services by the federal government was an issue that had been examined in depth for decades. A series of internal studies and task force reviews had pointed to the need to rationalize the Canadian food inspection system.

**12.24** Those reviews provided a solid rationale for resolving the long-standing problems associated with the federal food inspection system. The decision to move to a single food inspection system was delayed by concerns about departmental mandates, the lack of necessary resources and questions about the appropriate reporting structure.

**12.25** The consensus needed to resolve these issues was not reached until 1995. This undertaking flowed from a number of federal initiatives, including the Program Review exercises, renewed efforts for intergovernmental co-operation and a move toward innovative service delivery. After the government made a commitment in November 1995 to change the existing program, events proceeded very quickly. Exhibit 12.2 describes the milestones in the creation of the CFIA.

**12.26** **Strong support from senior management was evident.** The creation of a single food inspection agency from branches in three government departments required each department to transfer inspection programs and resources to the new Agency.

**12.27** Department heads might be expected to protect their own organization and give lukewarm support to a new agency that would reduce their own resources and programs. This was not the

case with the CFIA. Commitment by the government and the deputies and assistant deputy ministers involved was strong and consistent, and is considered by many to have been critical to the successful creation of the Agency. Their support was demonstrated through a variety of actions:

- encouraging co-operation and good working relations among the departments during the implementation phase;
- providing financial and human resources to establish an independent implementation team;
- agreeing to key steps in the implementation plan;
- consistently communicating the strong support the Agency had among ministers and central agency officials; and
- giving priority to the early creation of the Agency.

**Useful Practice:** Ensure that there is a clear rationale for change that has the strong support of ministers and senior management.

Exhibit 12.2

Milestones

| Date | Early History |
|---|---|
| 1970–1985 | Four key studies recognized that a single food inspection agency could provide benefits in co-ordinating food inspection activities. |
| 1986 | Interdepartmental Committee on Food Regulation (ICFR) established in response to Task Force on Program Review (The Nielsen Report, 1985). |
| 1994 | Auditor General critical of long-standing problems with food inspection system and unfulfilled mandate of ICFR. |
| 1995 | Federal Budget highlighted the need to improve the effectiveness and efficiency of the federal component of the Canadian food inspection system, including possible changes in organizational structure. Office of Food Inspection Systems (OFIS) established in May 1995 to review organizational options and conduct stakeholder consultations. |
| **1995 – 1997** | **Recent Events** |
| Nov. 1995 | Program Review ministers endorse the creation of a single federal food agency, and the expediting of the initiative through a two-phased transition process. |
| Jan. 1996 | Prime Minister approves initiative; Minister of Agriculture designated as responsible minister for the implementation. |
| Mar. 1996 | Federal Budget announces plans to consolidate all federal food inspection and plant and animal health services into a new agency. |
| June 1996 | Phase 1 complete – resources realigned between Agriculture and Agri-Food Canada (AAFC) and Health Canada (HC); health policy functions/resources to HC and inspection functions/resources to AAFC. |
| June-Aug. 1996 | Legislative drafting process. |
| Sept. 1996 | Prime Minister approves name of Agency and human resources regime; legislation introduced in House (Bill C-60). |
| Oct. 1996–Feb. 1997 | Preparation of final Treasury Board submission establishing the Agency and transferring resources from AAFC and Fisheries and Oceans (DFO) to the Agency. |
| Mar. 1997 | Approval of Treasury Board submission to make Agency operational; Bill receives royal assent on March 20. |
| Apr. 1, 1997 | First day of operations under the CFIA; Phase 2 complete – joining of AAFC (including former HC) staff and DFO staff; President appointed. |

**Transition managed by a structured and independent team**

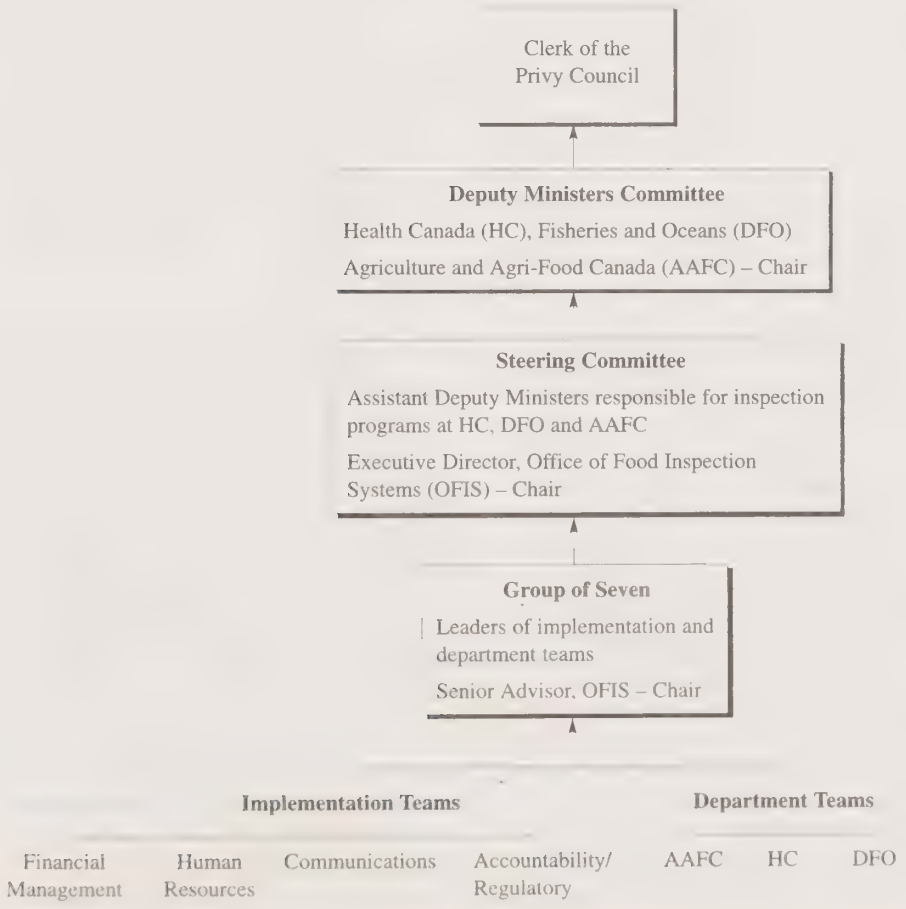
**12.28** Following the March 1995 Budget announcement of the decision to review the federal food inspection system, the Office of Food Inspection Systems (OFIS) was established in May 1995 to review organizational options with the three federal departments, industry, the provinces and other stakeholders. OFIS prepared a discussion paper that outlined four possible organizational options; this paper was the focus of stakeholder consultations across Canada. Subsequently, the government decided to create a single food inspection agency. OFIS was responsible for establishing the Agency's framework and preparing for the start of business.

**12.29** Throughout the period leading up to the creation of the CFIA, there was a strong commitment by OFIS and the parent departments to separate the work of the implementation team from the operations of the three affected departments. In this way the process of creating a new agency would not interfere with operations, and would ensure the continuity of food safety and quarantine programs. As a result, during the implementation period the inspection program continued to be delivered as before, and the implementation team was free to focus on creating the Agency. Exhibit 12.3 describes the structure used by OFIS. Two of the components of the implementation structure were OFIS and the "Group of Seven":

**During the implementation period the inspection program continued to be delivered as before, and the implementation team was free to focus on creating the Agency.**

Exhibit 12.3

**Implementation Team Structure**



- **OFIS** co-ordinated the changes required to move to the new Agency. It comprised 11 full-time professionals with experience in the three affected departments, in some central agencies and at the provincial level. The executive director of OFIS was the main conduit for communication with the central agencies and, in particular, the Privy Council Office. OFIS implementation teams were formed to cover the areas of human resources, accountability, financial management, and communications. Moreover, there were 20 additional subcommittees to work with the implementation teams, involving over 170 individuals.

- **Group of Seven** was the intermediary body that acted as a co-ordinating group. It was a consensual decision-making body chaired by the senior advisor of OFIS. It comprised the leaders of the four OFIS implementation teams and representatives from the three departmental committees, who acted as conduits between OFIS and their home departments.

**Useful Practice:** When it is essential to maintain uninterrupted service delivery, establish an implementation team structure separate from ongoing business. Ensure that the interests of the major affected organizations are represented on the team.

**12.30 Timing of appointments is key.** In creating a new organization, a key decision is when to appoint its chief executive officer. The appointment of a president-designate could be made at any time from the announcement of the intention to establish the entity until legislation is passed and the organization is up and running. On one hand, an early appointment provides a focus for decision making and allows the new senior executive a chance to shape the organization to his or her vision. On the other hand, in strained or particularly difficult circumstances an early appointment could exacerbate any disagreements among the affected departments and reduce the incentive to co-operate with the new appointee. As well, it could limit the effectiveness of the consensual approach adopted by the implementation team.

**12.31** Senior government officials and OFIS members discussed the timing of the appointment of the Agency's President. The President and Vice-President were first named as designated heads in February 1997 and then appointed on 1 April 1997, when the Agency began operations. This timing did avoid potential disagreements among the three affected departments, but there was a consequence: during the implementation process, there was no individual exclusively representing the needs of the future Agency in negotiating the allocation of assets.

**Practice to Consider:** Ensure that the needs and interests of the new organization are adequately represented prior to the appointment of the president or chief executive officer.

Team members left their "departmental jackets" at the door and this, along with the consensual approach, helped them develop a collective understanding of their purpose — to develop the best framework for the Agency.

### Consensual approach to decision making

**12.32** The decision-making approach adopted by OFIS, the Group of Seven and the implementation teams was consensual. This approach was supported by OFIS management and facilitated by the fact that teams were non-hierarchical and generally worked collaboratively toward agreed goals. When consensus could not be reached, the issue was moved up for decision by the involved assistant deputy ministers — something that occurred only a few times.

**12.33** This approach generated the broad discussion and debate that ultimately led to the key recommendations and decisions made in the implementation period. OFIS team members left their "departmental jackets" at the door and

this, along with the consensual approach, helped them develop a collective understanding of their purpose — to develop the best framework for the Agency.

**12.34 Some limitations to the consensual approach.** In our interviews, some members of OFIS indicated that a consensual approach was not useful when dealing with controversial issues under pressures of a short time frame. These pressures often forced teams to work on issues as they arose, rather than on other important matters with long-term implications, such as the development of the corporate business plan, the employee classification system and the organizational structure.

**Useful Practice:** Encourage a consensual approach to building an operating framework for a new agency. This facilitates the involvement and buy-in of all participants, which is important when several organizations are involved. However, resolution of more controversial issues might be deferred in a situation of a compressed time frame.

### Expertise in creating a new agency

**12.35** Dedicated resources working together are required to carry out the work of setting up a new organization that has the flexibilities offered the Agency. While no blueprint exists for creating agencies outside the traditional departmental structure, there is considerable experience on which to build. For example, at present over 20 organizations have separate employer status. The federal government has also created new organizations by transferring programs from several other departments, as it did in the case of the Canadian Space Agency, and other jurisdictions in Canada have established many agency-type organizations. We would expect that the expertise thus acquired would be sought out and used.

**12.36 Limited ASD expertise on the implementation teams.** Generally, those involved in the implementation process were at fairly senior levels in their departments and, in many cases, had strong technical or functional backgrounds that were relevant to the work involved in the implementation. However, their experience was generally limited to working within government departments and implementing existing policies. Few members had experience in setting up new organizations and establishing policies to reflect management and administrative flexibilities in keeping with the ASD approach.

**12.37 Limited use of outside expertise.** ASD arrangements need administrative regimes that are much more flexible in their design and operation. Drawing on relevant outside experience, whether from other government jurisdictions or the private sector, can provide important lessons and facilitate the implementation process.

**12.38** Implementation teams carried out most of their work in-house. Few external experts were brought in to provide complementary conceptual or technical assistance in the implementation process, but those who were called upon did have relevant experience.

**Practice to Consider:** Make good use of experience and expertise from outside federal departmental administration when setting up new organizations with flexibilities beyond those of traditional departmental structures and central policy regimes.

### Impact of compressed time frame

**12.39** A tight time frame was imposed on the implementation team. It had only 13 months, from the March 1996 Budget announcement until the legislation received royal assent in March 1997. This tight time frame presented benefits and challenges. In our interviews, team

members often noted that the time frames generated tremendous pressure on work teams and limited their time for dealing with difficult issues. For example, on 1 April 1997, many Agency systems were not yet in place, including financial and human resource systems. By 1 April 1998, the transition process was still under way for the corporate management groups, which were increasingly occupied with delivering services while still having to develop internal policies and processes.

The tight schedule certainly focussed attention on the task at hand and kept up the pressure to deliver the Agency on time.

**12.40** A deliberate decision was made to leave the details of the financial transfers and the human resource framework until after the launch of the new agency. This led to a phased-in approach. Issues and details that could not be resolved before the legislation was passed and that were not crucial to the legislation were deferred.

**12.41** At the same time, the tight schedule certainly focussed attention on the task at hand and kept up the pressure to deliver the Agency on time. Given the narrow window open in the parliamentary agenda as well as a pending election, there was real concern that taking time to resolve all issues would mean having no agency at all.

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**Useful Practice:** Implement a new agency through a phased-in approach as a way to deal with tight time frames. This allows implementation to proceed on time, even when there is insufficient time to deal with all issues or when complete agreement on all aspects of the agency has not yet been reached. However, unresolved issues can take significant effort to settle later on.

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**Effective communication and consultation about change**

Communication initiatives were viewed as a success by many stakeholders and staff involved in, or affected by, the implementation process.

**12.42** OFIS and the parent departments communicated throughout the implementation to ensure the involvement and support of working-level personnel, as well as other interested parties including consumers, industry and foreign governments. Communication initiatives were viewed as a success by many stakeholders and staff involved in, or affected by, the implementation process. Our own study largely corroborates this view.

**12.43** During our interviews, staff confirmed that OFIS and the parent departments had provided them with sound information. While they considered that the information provided was honest, there was often little information to share, given that many decisions were left until later. The fact that OFIS and parent departments were still able to marshal staff support and maintain trust throughout this organizational change is a major indicator of the success of the communication exercise.

**12.44** Consultation with stakeholders was undertaken and was integral to the development of the Agency. In 1995, for example, OFIS used a consultative process to elicit comments and ideas about organizational options for reorganizing the federal food inspection system. Based on extensive consultations with the three federal departments, industry, provinces, and other stakeholders, the government opted for the creation of a single agency.

**12.45** Throughout the implementation period, there were efforts to consult with affected groups prior to making decisions. The implementation team's firm commitment to an extensive process of consultation has been widely recognized.

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**Useful Practice:** Implement a communication strategy that incorporates consultation as a meaningful tool to involve employees and stakeholders — a key element in the successful implementation of a new service agency.

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## Key Challenges

### Transfer of program and corporate assets to the new Agency

**12.46** The process of identifying and allocating resources to the new Agency from the three affected departments proved to be complex and time-consuming. The new Agency would need to receive sufficient resources to establish a solid basis for fulfilling its mandate, including inspection resources, corporate overhead and physical assets such as buildings and laboratories. Similarly, the contributing departments had to be left with appropriate resources to deliver remaining programs.

**12.47** A number of factors in the CFIA experience affected the transfer process:

- It was a two-staged implementation — the realignment of Health Canada and Agriculture and Agri-Food Canada program components in June 1996, followed by the transfer of the Fisheries and Oceans and Agriculture components to the Agency on 1 April 1997.

- The inspection components in Agriculture and Agri-Food Canada and the Department of Fisheries and Oceans were largely self-contained and separate from other operations in those departments.

- Given the scope and complexity of Health Canada's planned laboratory rationalization, a decision was made to defer the distribution of corporate and physical assets related to facilities until after the Agency's creation.

- All parties recognized the need to maintain long-term working relations.

**12.48** **A structured approach was used to transfer program resources.** The accountability implementation team prepared an exhaustive list of the 51 federal activities in the three departments associated with food safety policy and standard setting, food inspection, and quarantine. As well as identifying who would become responsible for each activity on 1 April 1997, this accountability matrix was used to clarify shared roles and responsibilities. It was also used in deciding on the transfer of program resources. With the transfer of each activity, the transfer of program dollars followed. Based on the agreed responsibilities, the accountability implementation team then allocated these activities to either the Agency or Health Canada.

**12.49** Fixed assets were not valued, partly because the creation of the CFIA was not a sale of assets. Beginning with the fiscal year 1999–2000, the Agency intends to report its financial results using generally accepted accounting principles. At that time, it must value its assets. The task of valuing assets is difficult for any government entity, particularly when inventory records are incomplete or outdated. The Agency does not have a complete list of its assets. Given that the inspection programs transferred from parent departments were largely self-contained, however, all fixed assets such as laboratories, cars and equipment followed the program dollars and staff moving to the CFIA.

**12.50** At the request of OFIS, the three departments hired an outside accountant who reviewed the figures used in the transfer process. Participants confirmed that this, coupled with sign-off on the accountability matrix by the Assistant Deputy Minister Steering Committee, enhanced credibility and added discipline and rigour to the process of transferring program resources.

**12.51** The human resources implementation team developed criteria to identify those who would move to the Agency. Individuals who devoted 60 percent or more of their time to inspection services were designated a dedicated

The process of identifying and allocating resources to the new Agency from the three affected departments proved to be complex and time-consuming.

resource and were transferred. In some cases, non-dedicated staff (those devoting less than 60 percent of their time to inspection programs) were given the option to volunteer for transfer to any vacant positions. In other cases, transfers of staff were not feasible from the perspective of the parent department, and so dollars were transferred instead. This approach was not used to identify staff when they belonged to largely self-contained inspection units.

**12.52 Division of corporate resources was difficult.** The transfer of corporate resources was, however, difficult and continued to create problems for the Agency in the first year of operations. Many factors contributed to the difficulties. First, corporate staff are often multi-tasked and not easily separated from the parts of the organization that are not being transferred. Second, the implementation team did not use an agreed formula or methodology. OFIS proposed a formula based on a 1995 study that had been commissioned to project cost savings possible through a single-agency delivery system. However, there was no agreement to use this study in deciding on the allocation of corporate assets from the contributing departments to the Agency.

**12.53** The absence of decisions about the future management structure of the Agency made discussion about a corporate structure difficult. No formal analysis of the Agency's corporate requirements was carried out. As noted already, there was no designated individual representing exclusively the Agency's interests to negotiate the transfer of corporate assets and ensure that the Agency would have enough resources to fulfil its mandate. Finally, the outside accountant who was hired to oversee the figures used in the transfer of program resources did not play a significant role in the division of corporate assets.

**Useful Practice:** Based on a needs analysis, establish a framework or formula to identify both program and corporate resources to be transferred from existing organizations to a new agency and ensure that there is commitment to transfer resources according to the formula.

**Establishing a new human resource management regime**

**12.54** The CFIA experience demonstrated that this was a challenging but critical area.

**12.55 Implementation team focussed on options for the human resource regime and on the transfer of staff.** These were the primary preoccupations of the human resources implementation team. Following consultations with all stakeholders and discussions with the Treasury Board Secretariat, OFIS recommended that the legislation establish the Agency as a separate employer under the *Public Service Staff Relations Act* and outside the staffing regime of the *Public Service Employment Act*.

**12.56** The change to separate employer status and the move outside the staffing regime of the *Public Service Employment Act* were new territory for many involved in the creation of the Agency. The operational implications of this new status were not fully examined during the implementation phase; this was deliberately delayed until the first year of operations. As well, few members of the human resources implementation team or working groups became employees of the new Agency, which resulted in the loss of much of the corporate memory that had been developed during the implementation period.

**12.57** The work and communication efforts of the human resources implementation team as well as those of the parent departments led to over 99

percent of employees accepting an offer of employment with the Agency.

**12.58 Creating and implementing the Agency's human resource framework required time and resources.** In the Agency's first year of operations, a human resource strategy was developed in consultation with employees to support the CFIA business plan. The strategy outlined the key challenges facing the Agency in the next three to five years and was supported by a detailed work plan. As well, the strategy included a comprehensive set of values that governs the management of people in the Agency. These values serve as the foundation for human resource decisions, given that the Agency moved outside the *Public Service Employment Act*.

**12.59** Once established, the Agency recognized the time and resources required to establish its human resource framework as a separate employer, and the full complexity of the task. This resulted in a number of challenges, including the following:

- Mobility for CFIA staff within the public service was a concern. To facilitate mobility, the Agency established memoranda of understanding (MOU) with the parent departments for the inclusion of CFIA staff among those they consider when staffing positions. We note that closed competitions under the Public Service Commission's staffing regime are potentially open to all persons in the federal public service, including the Agency. Access to specific competitions in departments is determined by deputy heads, who have been delegated the Commission's authority to establish areas of selection in accordance with the Commission's policy and the terms under which the authority was delegated.

- When the Agency started operations, its Labour Relations unit was largely vacant until a Director was hired to head the unit in the fall of 1997. The Agency was faced with numerous tasks, including responding to notices to bargain with existing bargaining agents. Over the past year, the Agency worked with unions to define a new bargaining structure that reduced the number of bargaining units from 27 to 4, and also made significant progress in negotiating new collective agreements.

- The CFIA decided in March 1998 to adopt the Universal Classification System developed by the Treasury Board Secretariat. The Agency planned to modify the Secretariat's system to suit the Agency's requirements. The full roll-out of this classification system can be expected to be a lengthy and challenging process, but it may facilitate the integration of inspection functions from the three departments.

Once established, the Agency recognized the time and resources required to establish its human resource framework as a separate employer, and the full complexity of the task.

**Practice to Consider:** Recognize early on that establishing a new human resource management framework as a separate employer is a complex task. A new framework requires time and resources to design and implement.

**Early implementation of the accountability framework**

**12.60** The accountability framework is still to be tested. We reviewed the accountability framework set out in the Act and related documents.

- **Roles and responsibilities are set out.** The sorting out of roles and responsibilities was a key concern of the accountability implementation team. The team developed an accountability matrix that identified activities involved in the federal food inspection system. In addition, it identified any overlap and duplication of inspection services among the contributing departments. In this way, the team and the parent departments arrived at a common understanding of future roles and responsibilities of the key players.

The sorting out of roles and responsibilities was a key concern of the accountability implementation team.

In the area of food safety, the Act assigns roles and responsibilities to the ministers of both Health and Agriculture. The Minister of Health is responsible for establishing policies and standards related to the safety and nutritional quality of food. The Minister of Agriculture, through the Agency, is responsible for implementing those policies and standards; this includes the provision of all federal food inspection activities. The Minister of Health is responsible for assessing the effectiveness of the Agency's activities that relate to food safety. Thus, the legislation provided a check and balance for shared responsibilities in this complex area.

The legislation does not describe roles and responsibilities further. However, in one particular case, a memorandum of understanding between Health Canada and the Agency has been signed to outline roles and responsibilities and establish a working relationship in the area of food safety emergencies and related activities. In this way, the Agency and Health Canada have established a mechanism for clarification of roles and responsibilities. It is understood that roles and responsibilities will be reviewed further as the accountability framework continues to be used.

The Act gives the President of the Agency the authority to delegate power to "any person". This means that enforcement powers under the Act can be delegated to third parties, thus expanding the range of accountability. However, the Agency remains accountable to the Minister of Agriculture and ultimately to Parliament for the exercise of this power.

The Agency's objectives, strategies and expected performance are presented in its corporate business plan.

The clarity and effectiveness of these arrangements in the accountability framework still need to be tested as new events occur over time.

**Useful Practice:** Before establishing a new ASD arrangement, identify as clearly as possible the roles and responsibilities of the key players, especially in the areas of shared responsibility.

- **Review and adjustment mechanisms being developed.** The legislation does not provide any formal review mechanisms to settle disagreements that might arise in matters of shared responsibilities. It is up to the Agency and Health Canada to establish policies and protocols as needed to ensure co-ordination of their shared responsibilities. Some steps in this regard have been taken, as described above. In the area of food safety and recall, the Agency and Health Canada have a shared responsibility. They have signed a memorandum of understanding that provides for an annual review, the first of which resulted in a planned amendment to clarify procedures for the investigation and recall of food-borne matters that potentially can cause illness.

**Practice to Consider:** For new ASD arrangements that involve shared roles and responsibilities, establish specific procedures to resolve disputes and disagreements that may arise among the parties.

- **Performance expectations not yet known after one year.** In stating the government's objectives for the Agency, the Act provides only overall direction. The Agency's objectives, strategies and expected performance over that period are presented in its corporate business plan.

The corporate business plan was tabled one year after the creation of the Agency, in May 1998. It was based on extensive consultation, and reflects the needs of managers, clients and stakeholders. While the Agency's expected outcomes listed in the plan are results-oriented, they are not sufficiently concrete or precise to provide a good indication of what is to be achieved.

- **Balancing expectations and capacities.** It is perhaps too early to know if the transfer of assets from the three departments has achieved the right balance between resources and expectations. Concerns may yet be raised, for example, as to whether the transfer has left the Agency and the contributing departments with the appropriate resources to fulfil their respective mandates.

- **A credible reporting regime.** The reporting regime of corporate business plans and annual reports established in the legislation is sound. It has been strengthened by the Auditor General's role in providing an opinion on the Agency's financial statements and in assessing the performance information reported against the Agency's objectives. Although the Agency has been slow to develop its first annual report, due in the fall of 1998, it is beginning to implement a new results-based management framework. When implemented, this framework should provide a solid basis for reporting performance.

**Role of central government agencies in the creation of the new Agency**

**12.61** A number of central players were involved in the creation of the CFIA. The Privy Council Office was involved in decisions on the structure, organization and ministerial responsibility and accountability for the Agency. In addition, the Privy Council Office was, in the CFIA's policy context, concerned with policy and administrative issues related to intergovernmental relations, government renewal and strategic national priorities. Similarly, the Treasury Board Secretariat, acting on behalf of the Treasury Board, provided advice on good public management from a whole-of-government view, and in particular on agency-specific concerns in the areas of financial and human resource management. The Department of Justice supported this initiative by playing its key role of providing legal advice and legislative drafting services. The Public Service Commission was consulted with respect to staffing issues that were expected to arise in the transition from departmental status to agency status.

**12.62** Although there was no established blueprint for such an initiative, as is in keeping with the case-by-case approach adopted by the government, we would nevertheless expect that the central agencies would provide adequate and consistent guidance based on previous experiences with ASD-type initiatives.

**12.63** **Legal creation of the Agency.** In order to meet the government's deadline for tabling, the legislation had to be drafted by September 1996, six months after the Budget announcement to establish the Agency. It was during this period that the role of central agencies became critical to ensuring that the commitment to the schedule was met and that sufficient resources were available for the drafting process and related matters.

**12.64** For an intense six-week period, drafters from the Department of Justice worked to produce a draft of the Act. Individually, few components of the Act constituted a radical departure from the norm; but the whole was sufficiently different and complex that it required more work than a typical piece of legislation. Legal advice and legislative drafting services were co-ordinated by Justice in the areas of human resources law, expenditure management, and Crown law, among others.

The role of central agencies became critical to ensuring that the commitment to the schedule was met and that sufficient resources were available for the legislative drafting process and related matters.

**12.65 Clear direction needed from central players.** The establishment of new alternative service agencies was new territory for both the Treasury Board Secretariat and OFIS. At the same time that OFIS was seeking advice, the Secretariat was developing its own capacity to support the move to new alternative service delivery arrangements in a number of its policy centres. The Secretariat has informed us that it provided a wide range of support for the creation of the Agency. However, OFIS has told us that it did not always obtain clear and consistent advice and direction, particularly in the areas of human resource management and reporting requirements.

**12.66** In light of the trend toward establishing ASD arrangements, and given the CFIA experience, the Treasury Board Secretariat conducted an internal study to analyze the role played by the central agencies and identify lessons learned for the launching of future government initiatives in alternative service delivery. One of the lessons identified was the need for a central agency presence and for individuals within the central agencies to visibly support the move to a new organization. The Secretariat has understood this need and has taken steps to ensure that it provides strategic and consistent advice to teams implementing new ASD proposals. In our view, that study was a positive step to identify key lessons from the CFIA experience that could be used in preparing for other government ASD arrangements.

**12.67** The Public Service Commission is responsible for the application of the merit principle through the administration of the *Public Service Employment Act*. It had limited involvement in the creation of the Agency. As a separate employer that has authority to appoint its own staff, the Agency becomes solely responsible for maintaining core public service values.

**12.68** With respect to the provision of legal advice by lawyers from Justice, there appears to be some uncertainty about how to best serve the needs of an emerging entity. The departments and central agencies involved in the creation of the Agency each had Justice lawyers ensuring the representation of their interests. However, several participants we interviewed pointed to the absence of similar legal representation to look out for the interests of the future agency.

**Practice to Consider:** Make it standard practice, given the government's case-by-case approach to establishing ASD arrangements, to bring together and provide the best advice possible to new agencies being set up, and make sure that the lessons learned in each case are well documented and communicated.

## First Year of Operations

**12.69** We have discussed the establishment of the CFIA, which occurred over the 13 months from March 1996 to March 1997. For the subsequent 12-month period, that is, between 1 April 1997 and 1 April 1998, the focus of our study was on the progress made by the Agency toward establishing its organizational structure, maintaining inspection systems and practices, and developing financial systems.

**12.70 Ongoing development of the Agency.** There are numerous approaches to establishing a new organizational structure. It can be done early, as soon as the new organization has been formed; or, as in the case of the CFIA, it can be done in a more incremental manner. In both cases, a certain amount of anxiety will be created.

**12.71** During the first year of operations, staff were uncertain about their future roles and responsibilities and concerned about their employment status once their two-year job guarantee expires on 1 July 1999.

**12.72** In April 1998, based on the recommendations of management working groups, the Executive Committee announced a new organizational structure that realigned functions at all levels of the Agency. The development of the Agency's organizational structure had been a lengthy process because the creation of the Agency was not only a consolidation of inspection services from three government departments. It also involved the creation of an organizational structure that would support the management of the transition to a number of new approaches. These included separate employer status; financial systems and practices in accordance with generally accepted accounting principles; performance reporting; and finally, a risk-based approach to food inspections. The challenge was to embrace all of this in an organizational and management structure, while ensuring the continuity of the inspection program. Nevertheless, there was a significant amount of frustration among staff who were expecting more and faster change.

**12.73** Throughout the establishment of the CFIA, inspection operations generally remained unchanged; inspection systems and procedures used before April 1997 were largely maintained during the first year. The Agency ensured that trade with international partners continued without interruption. Important industry-related changes that had been occurring before the Agency's creation continued to be implemented. Now the Agency is also moving ahead with its commitment to work toward an integrated system of food inspection based on the harmonization of standards with provincial, territorial and municipal governments.

**12.74 Financial systems and practices being developed.** Before 1 April 1997, there was no formal analysis of what would be required of the Agency's financial systems at the start of business. The Agency started operations with few resources in its financial function and without its own financial systems and practices. During the first year of business, most of the financial staff came from Agriculture. The Agency had signed memoranda of understanding with the three parent departments for financial, informatics and/or administrative services. It had also opted to share a number of services with Agriculture and Agri-Food Canada through memoranda of understanding. This was a deliberate decision intended to cause minimal disruption and avoid duplication of existing systems and practices.

**12.75** The Agency has taken an incremental approach to preparing its financial statements in accordance with generally accepted accounting principles (GAAP). It has been working on developing its financial reporting systems to reflect its operational requirements, and on making certain that appropriate financial and management systems are in place before the shift is made. In its recently issued corporate business plan, the Agency stated its intention to move to full accrual accounting for 1999–2000. This will be important to:

- provide users of the statements with a complete report of the Agency's operating costs, its resources and its obligations;
- present the results of its operations in a manner that matches outputs to the resources used to achieve those results; and
- facilitate improved financial management and controls.

**12.76** There were consequences of adopting an incremental approach. On the positive side, operational managers continued to receive financial reports in the format to which they were accustomed and financial staff were able to use familiar systems and practices. This contributed to minimizing unnecessary disruption and to maintaining a more consistent control environment. It also minimized the number of overall changes

**The Agency has taken an incremental approach to developing its financial function and new organizational structure.**

occurring throughout the Agency during the first year of operations.

**12.77** However, this approach limited the extent to which significant advancements in financial management and reporting could be made in the Agency's first year of operations; for example, its first financial statements will not include a balance sheet showing its assets or its liabilities. The Agency also continued to have difficulty providing data to support its user fee charges that would meet industry's expectations. Further, with the delay in finalizing an Agency financial function, there was some apprehension among regional financial staff about their future within the Agency.

**Practice to Consider:** Early establishment of a well-defined financial function increases a new agency's capability to manage its new financial flexibilities from the outset of operations.

## Conclusion

**12.78** Our study focussed on two stages: the successful creation of the Agency with the passage of the enabling legislation; and its first year of operations. The first stage of the reorganization was completed in a compressed time frame. Early in the process, senior government officials established a timetable. The implementation team, senior departmental officials and the central agencies maintained momentum for change. The legislation was passed on schedule, 13 months after the Budget announcement. The support and dedicated resources ensured the successful creation of the Agency.

**12.79** The CFIA faced a number of challenges in setting up its management framework to operate as a new service agency. It has had to consolidate programs from three departments and work on the configuration of a new organizational structure; it has been co-operating with Health Canada and with other levels of government to streamline inspection programs nationally; it has been developing its own identity and culture as an agency. The Agency has also worked to meet the expectation that it would be more innovative, flexible and efficient in the delivery of services. The Agency has had to do this under pressures of time and, more significantly, while ensuring the continuity of food safety and quarantine programs.

**12.80** Many demands lie ahead. The Agency has the legislative authority to operate with greater autonomy and flexibility. The real challenge is to use this new flexibility to meet the government's commitment to a new and better way of delivering services. The concern is that the longer the Agency takes to create systems and practices that reflect its powers, the more it risks falling back into traditional ways of doing business.

The real challenge is to use this new flexibility to meet the government's commitment to a new and better way of delivering services.

# About the Study

## Scope

We focussed our study on two periods of time: the implementation period starting with the Budget announcement to create the Agency, March 1996, until the passage of the enabling legislation, March 1997; and the first year of operations, April 1997 to April 1998. We reviewed key factors and challenges during the implementation period. In addition, we examined the first year of operations in relation to the Agency's organizational structure and systems and practices. This was a case study of one government transformation of services to an ASD agency.

## Objective

The objectives of this study were to:

- describe the reorganization of the federal food inspection system;
- describe the Agency's progress during its first year of operations; and
- identify practices to consider in ASD arrangements.

The study did not include an assessment of the Agency's performance. Rather, it was a case study of a move to a legislated service agency. Although we identified a number of sound practices in this particular case, their applicability to other ASD arrangements would depend on the circumstances.

## Approach

Our findings and conclusions were based on extensive interviews with the players involved in the Agency's implementation period and its first year as an agency. We reviewed available written materials on the experience and made numerous site visits.

## Study Team

Assistant Auditor General: Maria Barrados
Principal: John Mayne
Director: Patricia MacDonald

Christina Brooks
Adèle Lamoureux
John Rossetti
Frances Smith
Gordon Stock

For information, please contact John Mayne.

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# Report of the Auditor General of Canada to the House of Commons

## Chapter 13
National Energy Board

**September 1998**

Report of the

# Auditor General of Canada

to the House of Commons

Chapter 13

National Energy Board

September 1998

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# Chapter 13

## National Energy Board



*The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.*

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# National Energy Board

## Main Points

**13.1** The *National Energy Board Act* has not been amended significantly since it established the National Energy Board (NEB) in 1959. While the NEB has been given some new responsibilities in areas such as frontier activities, its role has not changed much since its creation. However, its modus operandi has changed significantly. Through regulatory changes, the Board has moved from an interventionist approach to reliance on market-based forces, industry self-regulation and negotiated toll structures. During this period of evolution, the NEB has moved its operations from Ottawa to Calgary, downsized its staff complement by 35 percent and reorganized itself internally for greater efficiency. However, it has not objectively measured the extent to which it is being effective and relevant.

**13.2** The Board has recognized that the aging of the Canadian pipeline system poses potential threats to public safety and the environment. The number of reported pipeline incidents has increased in recent years. A risk assessment methodology is being developed that should improve the targeting of inspections and safety audits. However, deficiencies in information management will need to be addressed.

**13.3** The Board's ability to fully meet its environmental regulatory responsibilities is at risk due to shortfalls in its environmental inspection program — namely, in setting priorities and scheduling inspections and in inspection practices, which are too informal and unstructured.

**13.4** Since 1991, the NEB has recovered most of its costs from industry. No change has yet been made to its cost allocation method, despite some concerns expressed by stakeholders about its fairness. The NEB has settled for simplicity at the expense of cost causality. The Board does not have a cost accounting system; it needs to recover costs in a way that is more equitable and acceptable to stakeholders.

**13.5** The NEB is moving toward management for results, by adopting a new accountability framework and changing its style of decision making. While it is too early to evaluate the results of this initiative, we noted that significant opportunities exist to better link its human resource management activities to its vision of the future. In addition, the NEB will need to state and report clearly what it wants to achieve, monitor its performance on a regular and systematic basis and better link the results achieved to the costs.

# Introduction

## What Is the National Energy Board?

**13.6** The National Energy Board (NEB or the Board) is an independent regulatory tribunal reporting to Parliament through the Minister of Natural Resources. Its main responsibilities (Exhibit 13.1) are defined in the *National Energy Board Act* and the *Canada Oil and Gas Operations Act*. Most of the Board's activities deal with international and interprovincial oil and gas pipelines and exports. It has few activities dealing with the electrical sector, and staffing in that area has been reduced to four people.

**13.7** The NEB's corporate purpose is to make energy-related regulatory decisions that are fair, objective and respected. The Board promotes:

- reasonable transportation costs and fair access to shippers, and fair return on investment;
- the functioning of the energy market without disruption;
- fair market access by Canadians to energy proposed for export; and
- safety and environmental protection.

**13.8** The NEB expenditures for 1997–98 were $28 million, of which about 90 percent is recoverable from regulated companies. It has a staff complement of 277.

### Evolution of the National Energy Board

**13.9** The NEB was formed when government regulation had more public acceptance, at least for the oil and gas industry, than it appears to have now. The past decade has seen a major shift by government from detailed intervention by means of regulation toward a more market-based process of economic decision making. The NEB is changing its modus operandi in light of these shifts in societal perspectives on regulation, and has modified its processes and internal management structure correspondingly.

**13.10** Moving from a strictly regulatory process to one more broadly influenced by a market-driven economy has seen the NEB start to play a less significant role in some areas. Although it still regulates various companies in the pipeline and electrical sectors, the degree of regulation has changed. It no longer micromanages the regulatory process, and many of the functions previously carried out have been reduced or ended.

**13.11** The NEB has adapted its regulations and processes to the changing energy market and to resource constraints (Exhibit 13.2). For example, in the last 10 years it has changed its processes for toll approval, financial surveillance and assessing long-term gas export licences. Even though the NEB processes have changed, the *NEB Act* has not been amended fundamentally since the Board was created in 1959. Oil and gas commodities are still transported by a few pipeline systems holding dominant market positions, and therefore may require some regulation.

Even though the National Energy Board (NEB) processes have changed, the *NEB Act* has not been amended fundamentally since the Board was created in 1959.

**13.12** Up to 1985, long-term gas exports were approved under section 118 of the *NEB Act* only after the NEB was satisfied that Canada would still have a strategic reserve. Since price deregulation in 1985, procedures for assessing long-term gas export licences have changed three times. In particular, the *NEB Act* was amended in 1988 to reflect the Canada-U.S. Free Trade Agreement (FTA). The FTA made it more difficult for the Board to intervene in the free flow of energy commodities across the Canada-U.S. border. Now the NEB approves export licences provided that Canadians have access to the oil and gas at competitive prices. In 1997, sales under export licences, typically lasting for 10 years, represented about 35 percent of total export gas sales compared with 78

Exhibit 13.1

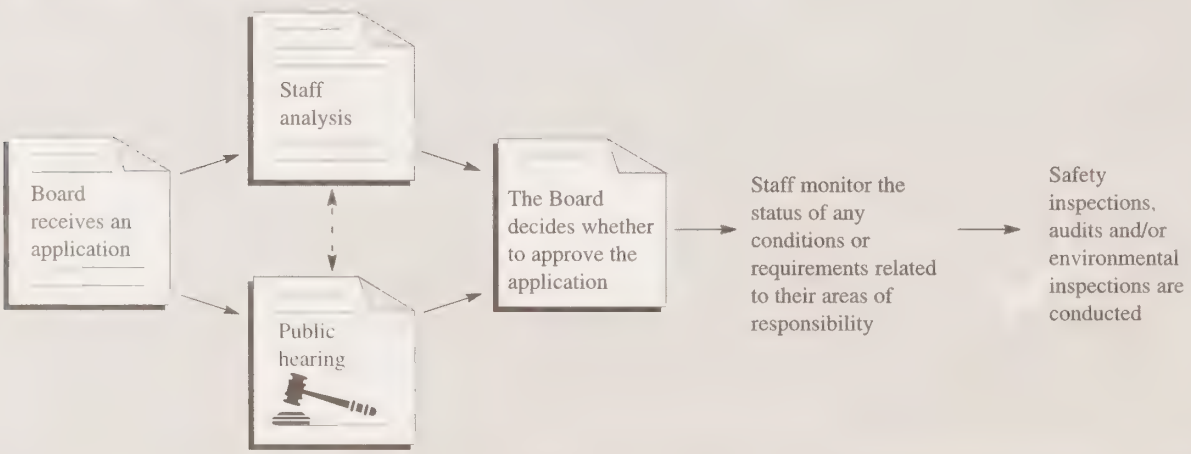
**National Energy Board Responsibilities and Processes**

The *NEB Act* allows for up to nine Board members. The Chairman is the NEB's chief executive officer and has responsibility over supervision and direction of the work and staff of the Board. In addition, up to six temporary Board members may also be appointed, subject to terms and conditions set out by the Governor in Council. At the end of 1997, the Board consisted of nine members, four of whom were temporary.

**The National Energy Board is primarily responsible for:**

- approving the construction, operation and abandonment of interprovincial and international oil, gas and commodity pipelines as well as international and designated interprovincial power lines;
- approving pipeline tolls and tariffs;
- approving oil, gas and electricity exports, and natural gas imports;
- environmental protection during construction, operation, maintenance and abandonment of pipelines and power lines within its jurisdiction;
- promoting the safe operation of pipeline facilities;
- providing advice, upon request, to the Minister of Natural Resources on matters pertaining to the Board's regulatory expertise;
- regulating oil and gas exploration and production activities, including safety and environmental issues, on Canada's frontier lands that are not subject to federal–provincial accords.

**The Application Process in Brief**




**Notes:**

– For major applications, the Board holds public hearings, either written or oral proceedings, where applicants and interested parties can participate. Before a hearing, individuals, interest groups, companies and other organizations are given an opportunity to register as intervenors or interested parties and in this way actively participate in the process.

– Each Board's decision is included in a published document called "Reasons for Decision".

Exhibit 13.2

**Key Historical Dates for the National Energy Board**

| | |
|---|---|
| **1959** | Establishment of the NEB. |
| **1970** | Proclamation of the licensing provisions for exports. |
| **1973** | The Board recommended oil export controls. |
| **1974** | Export tax converted to export charge and collection was delegated to NEB. |
| **1975** | *Petroleum Administration Act* passed by Parliament, giving Cabinet the power to regulate oil and gas prices. |
| **1980** | Announcement of the National Energy Policy. |
| **1981** | Amendment to the *NEB Act* to establish new procedures for determining the route of a pipeline and acquisition of the right-of-way, and to deal with compensation and damage claims resulting from the construction of a pipeline. |
| **1982** | Amendment to the *NEB Act* that broadened the Board's authority to permit expropriation for international and interprovincial electric power lines.<br>Adoption by the Board of a change in procedure to take into account actual instead of authorized level in determining the amount of surplus natural gas in Canada available for export. |
| **1983** | Amendments to the *NEB Act* that provided new measures to protect the rights of landowners. |
| **1984** | Demise of the National Energy Policy. |
| **1985** | Deregulation of oil and gas. Agreement between the federal government and the three western gas-producing provinces allowing gas buyers to contract for supplies with producers, marketers and other agents at freely negotiated prices.<br>End of export charge. |
| **1986** | A new surplus determination procedure, based on maintaining a ratio of 15 years between reserves and total annual production, was adopted by the Board to determine the surplus of natural gas in Canada available for export.<br>The Board decided to classify oil and gas pipelines in two groups, aimed at reducing the need for financial regulation. Tolls of smaller companies (Group 2) are to be reviewed only on receipt of a complaint. |
| **1987** | Adoption of new procedures called the market-based procedures for determining the surplus of natural gas available for export. |
| **1988** | *NEB Act* amended to take into account the Canada-U.S. Free Trade Agreement.<br>New electricity export policy announced by EMR Minister, which reduced regulatory requirements for exporting electricity and for international power lines. |
| **1990** | The Board changed its Market-Based Gas Export Procedures to no longer include social benefit-cost.<br>*NEB Act* amended to give effect to the government's electricity export policy and to recover the cost of its operation from the industries it regulates.<br>Creation of the Transportation Safety Board, which is given priority over NEB to investigate incidents related to the operation of a pipeline. |
| **1991** | The government announced the transfer of responsibility for the oil and gas regulation in the North (Frontier) to the NEB.<br>The Board moved from Ottawa to Calgary. |
| **1992** | NEB was granted Separate Employer Status. |
| **1995** | *Canadian Environmental Assessment Act* took effect and NEB is deemed to be a "responsible authority".<br>Established the cost of capital for major pipelines on a generic basis and provided for automatic annual adjustment of the rate of return on equity.<br>NEB approved the first negotiated settlement between a pipeline company and its shippers, reflecting an incentive-toll methodology and associated tolls and tariffs. |
| **1997** | Internal reorganization from 10 branches to five business units. |

percent in 1987. The balance of 65 percent represents exports under short-term orders, which apply for a period of up to two years and are renewed automatically upon request.

**New challenges**

**13.13** The oil and gas industry is highly active at present, with commensurate impacts on the NEB's workload. The proposed construction of new pipelines in the next few years raises the likelihood of increased competition among companies, which might move the Board into an arbitration role and could result in further changes to regulatory approaches.

During the last 10 years, the NEB has changed significantly, with reductions in staff by 35 percent to about 277, a move to Calgary in 1991, and an internal reorganization in 1997.

**13.14** In the1998–99 Report on Plans and Priorities, the Acting Chairman noted that the energy industry is at a dynamic stage and its relationship to environmental and safety considerations is evolving. The recent burst of industry activity has resulted in increased workload for the NEB and, at the same time, has produced job market conditions that make it very difficult for the NEB to attract and retain qualified staff.

## Focus of the Audit

**13.15** The Board operates in a quasi-judicial manner. Its decisions and the evidence presented are all on the public record. Therefore, we did not examine the hearing or evidentiary processes. Instead, we looked to see what strategic challenges face the Board and we concentrated our audit effort on them, including important management processes and key operational aspects. More details are included in **About the Audit** at the end of the chapter.

**13.16** During our work, we consulted extensively with the pipeline industry and various associations, both in person and through a telephone questionnaire.

# Observations and Recommendations

## Reorganization to Focus on Results

**13.17** During the last 10 years, the NEB has changed significantly, with reductions in staff by 35 percent to about 277, a move to Calgary in 1991, and an internal reorganization in 1997.

**13.18** The reorganization was aimed at increasing operational effectiveness. The internal structure changed from 10 functionally structured branches (for example, engineering) to five results-focussed business units: Applications, Operations, Commodities, Information Management and Corporate Services. Each of these units is headed by a business leader. Collectively, the business leaders, along with the Executive Director, constitute the Executive team, which is accountable to the Chairman of the Board. We discuss in paragraphs 13.83 to 13.97 the challenges the NEB faces as it moves toward managing for results.

**13.19** It is too early to evaluate the results of this change. We understand that the NEB is planning to conduct a survey in the near future to get feedback from its staff. We encourage it to do so and to monitor and report the results to the Board.

## The Trend Toward Negotiated Tolls

**13.20** Historically, tolls on major pipelines were set through a cost-of-service methodology that required detailed analysis and approval processes. Recently, a growing number of tolls in the larger companies have been products of negotiated settlements between shippers and pipelines that reflect the business risks and appropriate financial returns or shared cost-saving incentives. For other pipelines, usually smaller ones, tolls are approved subject to the filing of a

complaint. In essence, the operational approach to ensuring that tolls and tariffs are just and reasonable has been altered over the years.

**13.21** The results expected from the move to negotiated incentive settlements are lower transportation costs and a reduced regulatory burden. Since the introduction of negotiated settlements, the NEB has exempted companies from having to provide information on their financial and operational performance pursuant to Toll Information Regulations. To protect the public interest, however, it does need to monitor the effectiveness of its new processes.

## Operations in Support of the Regulatory Process

**13.22** As the Board considers applications made by pipeline companies, its staff provides analytical support to the approval process. Two elements, safety and the environment, are given particular emphasis under federal legislation. These elements extend beyond the approval itself, into pipeline construction, operation and ultimately abandonment when the pipeline is no longer useful. The Board may impose specific conditions in its approval, and the *NEB Act* sets out severe penalties if these are not complied with.

**13.23** We examined how the NEB manages its safety and environmental responsibilities under the applicable legislation. Major responsibility for these functions is vested in the Operations Business Unit, with the Health, Safety and Environment and the Pipeline Integrity teams. These teams employ specialists, including engineers and environmental scientists, and have a total staff of about 20.

**13.24** Given the resources it has available, the Board has chosen an approach for its regulatory regime that relies in part on co-operation with the industry. In the light of that approach, we expected to find that the NEB had adopted a risk-based approach to its inspection and monitoring processes, based on good

Since the introduction of negotiated settlements, the NEB has exempted companies from having to provide information on their financial and operational performance.



*Investigative dig (see paragraph 13.26).*



information. The extent to which it has done so is described below.

### Safety and environmental regulatory responsibilities

**13.25** Pipelines transport oil, natural gas and other commodities over great distances and ensure a reliable supply for residential, commercial and industrial consumers. Even though the number of accidents with pipelines is extremely low compared with other modes of transport, the construction and operation of pipelines is not without risks. The NEB tries to ensure that such risks are properly identified, managed and minimized. Exhibit 13.3 provides details on how it regulates safety and environmental matters.

**13.26** Pipeline companies have the primary responsibility for environmental compliance and operational safety of the pipelines. The existence of laws, and the threat of lawsuits by injured parties along with the associated potential loss of revenues, provide strong incentives for owners to comply with the rules. But the NEB also has an important responsibility for ensuring that owners comply with the applicable laws. It accomplishes this through making regulations, assessing applications, imposing specific conditions, conducting inspections and audits and investigating incidents.

Exhibit 13.3

**How NEB Carries Out Its Safety and Environmental Responsibilities**

| Critical Steps in Pipeline Cycle | NEB Safety and Environment Responsibilities |
|---|---|
| **Design** | – Develops and maintains regulations<br>– Develops guidelines related to filing requirements<br>– Assesses applications to ensure that they meet safety requirements and environmental assessment<br>– Establishes terms and conditions for approval |
| **Construct** | – Conducts construction inspections<br>– Monitors and enforces terms and conditions<br>– Follows up post-construction reports |
| **Operate** | – Conducts regular on-site inspections<br>– Conducts pipeline crossing audits and inspections<br>– Conducts documentation and safety audits at company office<br>– Follows up landowner concerns<br>– Records accidents/incidents<br>– Investigates significant accidents[1]<br>– Monitors companies' responses |
| **Abandon** | – Assesses whether there are any adverse environmental effects and what restoration work is required |

[1] Shared jurisdiction with the Transportation Safety Board.

### The risks of aging pipelines

**13.27** Public concerns over safety and the environment have increased as pipelines have aged. About 60 percent of the present 40,000 km of pipeline regulated by the Board was constructed more than 20 years ago (Exhibit 13.4). Safety and environmental issues include potential injury or death of pipeline company employees or members of the public, degradation to the environment, and damage to public and private property.

**13.28** Pipeline age alone may not be the sole determinant of risk; construction practices, methods and materials, along with maintenance practices, also play a part. Nonetheless, older pipelines are receiving more attention.

**13.29** The NEB has recognized pipeline integrity as an emerging risk area, but has not analyzed its regulated pipelines by age or location. At present the Board keeps a separate paper file on each reported incident. It records basic information including the date, company name, location, a short description of the incident, the category or type of incident, the consequences, and the action taken by

the company. The NEB has an electronic data base, but it has not been updated since February 1997 and is of limited use in determining trends and identifying risk areas. For example, data showing the relationship between pipeline ruptures and aging could not be retrieved because they are not collected that way. The NEB notes that it has been working for the past year with industry to collect more comprehensive data to support risk management. Because this initiative is not complete, the NEB does not know whether it will be satisfied with the results and may yet have to develop its own system.

**13.30** The NEB has a limited number of human resources to carry out its safety and inspection activities. Thus, it must be able to work co-operatively with other regulators or agencies and pipeline owners to discharge its regulatory responsibilities adequately.

**Pipeline incidents follow-up**

**13.31** Reported pipeline incidents per thousand kilometres of regulated pipeline have increased by 73 percent in the last five years (Exhibit 13.5). The most prevalent types of incidents are uncontrolled spillage, usually of liquid oil product, and uncontrolled escape of natural gas and high-vapor-pressure products. Since 1992, significant ruptures have totalled 18, with a high of 6 in 1994.

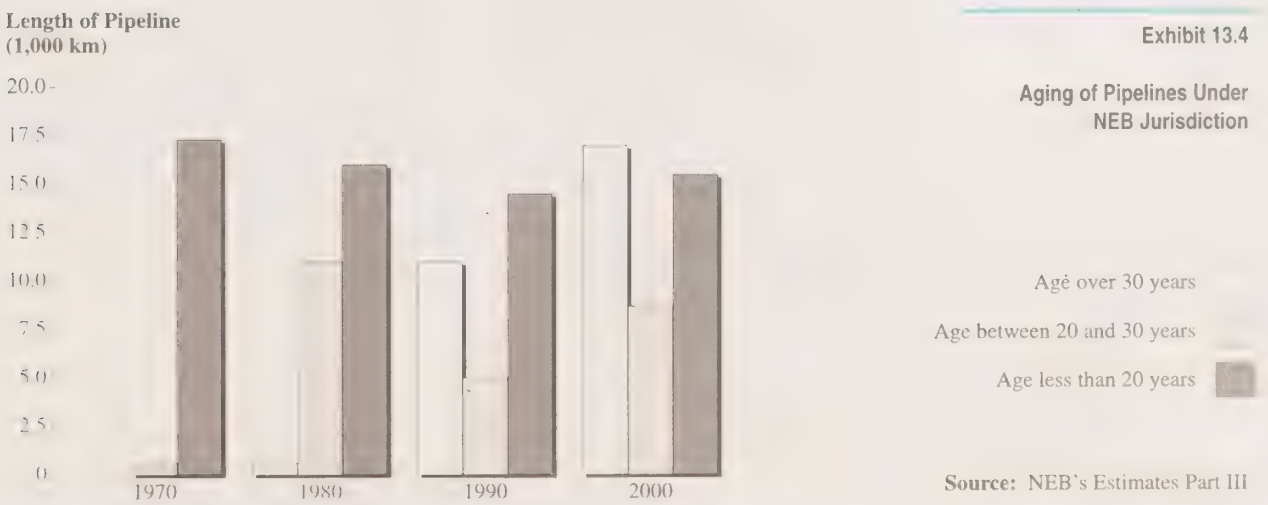
**13.32** Section 60 of the Onshore Pipeline Regulations requires pipeline companies to report to the NEB any incident involving the construction or operation of a pipeline that results in a fatality or injury requiring hospitalization, a fire or explosion, an oil spill, a pipeline rupture, or any other failure or malfunction of the pipeline. The NEB reviews all reported incidents. For major incidents involving serious injury or the release of large volumes of oil or natural gas, it conducts detailed on-site investigations. It then produces a report containing its findings and recommendations aimed at preventing future similar incidents.

**13.33** We examined four incidents investigated by the NEB to see whether reasonable corrective measures had been taken as a result of its recommendations. While we found evidence of follow-up on these recommendations, we noted that the NEB does not have a tracking system to provide assurance that all recommendations are followed up and that

**The NEB has recognized pipeline integrity as an emerging risk area, but has not analyzed its regulated pipelines by age or location.**

Exhibit 13.4

**Aging of Pipelines Under NEB Jurisdiction**




**Source:** NEB's Estimates Part III

corrective measures taken are documented.

**13.34 The National Energy Board should:**

- **increase its capacity to analyze pipeline incidents by improving its data base, including the sharing of data with other jurisdictions and other regulators; and**
- **improve its management of information to ensure that recommendations arising from pipeline investigations are systematically followed up and that corrective measures taken are documented.**

The NEB has attempted, where practical, to reduce regulatory overlap and provide more efficient regulatory services.

***Board's response**: The Board accepts the recommendation and will implement an internal data base for the tracking of recommendations by 30 September 1998. The NEB will develop an action plan by 30 October 1998 to improve its data base for pipeline incidents with a longer-term goal of having a data base to be shared with other jurisdictions in place by December 1999. We will build on existing initiatives to ensure that the Board's needs and those of other regulatory agencies and the industry are met.*

**Safety and environmental interfaces with other jurisdictions**

**13.35** The Board has identified many areas where it could work effectively with other organizations. It has attempted, where practical, to reduce regulatory overlap and provide more efficient regulatory services.

**13.36** The Board in the past has assumed a mandate for environmental protection as a component of the public interest under the *NEB Act*. Since 1995, the *Canadian Environmental Assessment Act* requires that all projects that can impact the environment undergo appropriate levels of assessment before they are approved. The Board, as a "responsible authority" under the *CEA Act*, ensures that such environmental assessments are conducted for projects under its jurisdiction, taking into account the factors set out by that legislation. Arrangements are being made between the NEB and the Canadian Environmental Assessment Agency to harmonize their quasi-judicial and administrative processes.

**13.37 Shared jurisdiction.** There is also a matter of shared jurisdiction: since 1990, operating pipeline incidents must also be reported to the Transportation Safety Board. Parliament has mandated both the NEB and the Transportation Safety Board to investigate essentially the same things.

**13.38** While the NEB can investigate incidents, it cannot, under section 14(3) of *The Canadian Transportation Accident Investigation and Safety Board Act*, conclude about their causes and contributing factors where the Transportation Safety Board also investigates. From 1991 to 1997, the Transportation Safety Board has investigated 24 operating pipeline incidents. We question whether it makes sense for pipeline companies to report incidents to two entities with similar jurisdictions and for both of them to investigate.

**13.39** Two separate studies have examined this sharing of jurisdiction. On one hand, the 1994 Report of the Canadian Transportation Investigation and Safety Board Act Review Commission held that jurisdiction should be retained by

Exhibit 13.5

**Pipeline Incidents per Thousand Kilometers of Regulated Pipeline**

| | 1992 | 1997 |
|---|---|---|
| Incidents reported[1] | 48 | 88 |
| Approximation of thousands of kilometers of regulated pipeline[1] | 37,800 | 40,000 |
| Incidents per 1000 km | 1.27 | 2.2 |

[1] Source: NEB Annual Reports

the Transportation Safety Board, because of a potential for conflict between regulators and those in charge of accident investigations. It recommended that the NEB's jurisdiction be restricted to investigating accidents involving new or rebuilt pipeline construction. On the other hand, a Regulatory Review Report 1992–1994, published by the Treasury Board Secretariat, noted that a Minister's Advisory Panel had endorsed an NEB recommendation to delete pipelines from the mandate of the Transportation Safety Board. No changes have yet been made to either Act to reflect the concerns raised.

**13.40** Since 1994, the two agencies have had a memorandum of understanding setting out a protocol for co-ordinating their respective investigations of operating pipeline incidents. However, this does not address the broader issue of shared jurisdiction. We were advised that the two entities are examining ways of harmonizing their reporting criteria as well as the possibility of having incidents reported to only one of them.

**Need to improve information management and ensure compliance with Board approvals**

**13.41** When the Board approves pipeline construction, it may include terms and conditions to which applicants must adhere in addition to the applicable legislation and approved specifications and procedures. In cases of non-compliance, the Board is empowered to impose a penalty of up to $1 million and/or jail terms. The Board uses a graduated approach to resolving any non-compliance. First, it requests the company to provide its Assurance of Voluntary Compliance; second, it issues a Board Order compelling the company to rectify the situation if no Assurance of Voluntary Compliance is received; and third, it imposes a penalty. As a result of this graduated approach, no penalty has ever been imposed. A system of penalties for repeated or persistent non-compliance was to be developed in 1997–98, but this was not done.

**13.42** Since the *Canadian Environmental Assessment Act* was enacted, the number of environmental conditions attached to the issuance of pipeline certificates has increased and is generally in the range of 15 to 30 per certificate. The Board has started to establish tracking systems on large projects to ensure compliance with the conditions. In 1996, for example, it created a Project Working Group to ensure compliance with Board conditions and to oversee the inspection program of a major pipeline project. However, because the NEB does not keep track of conditions for all Board approvals, it cannot provide assurance that they have been properly followed up.

**13.43** Compliance with terms and conditions of regulatory approvals was identified as one of the 1998–99 performance measures for the Operations Business Unit. We believe that the NEB needs to have data to be able to provide assurance to the Board that all conditions attached to its approvals have been properly monitored for compliance, and to provide feedback on the effectiveness of the conditions.

**13.44** The NEB has to work co-operatively with the pipeline industry to fulfil its regulatory responsibilities while preserving its independence. Under the Onshore Pipeline Regulations, pipeline operators generate useful environmental information through their own monitoring and surveillance programs. However, this requires direction from the NEB. Such direction has been the subject of a proposed guideline for the monitoring and surveillance program. The NEB has access to the data gathered by the pipeline operators. If verified regularly and combined with information collected under its inspection program, this could constitute an environmental data base or historical record both for reporting performance and for evaluating the

Board's environmental decisions. But this would require a more comprehensive environmental information management system than is currently in place and an effective environmental audit program, which does not now exist.

**13.45** The NEB lacks an effective information system necessary to support assessment of the cumulative effects of pipelines on the environment. It needs to collect such data not only for its own use but also for co-ordinating its work with other agencies, thereby ensuring that all available information is "on the table" to facilitate regional and local land-use planning and associated activities.

**13.46** An effective environmental information system provides a basis for sound strategic and tactical planning, and a means of reporting the results achieved. It can also be used to identify and evaluate risks, and can help in determining the resources needed to meet legal responsibilities. It is therefore in the NEB's interest to have up-to-date information systems in order to be able to function efficiently and effectively. The NEB has recognized many of the shortcomings of its information management system with respect to environmental issues, but has not yet developed a specific action plan to rectify the situation.

Due to resource constraints, 40 percent of scheduled safety audits were not carried out in 1997–98.

**13.47 The National Energy Board should:**

- **determine its environmental information management needs and develop an appropriate system; and**
- **ensure that all requirements associated with Board approvals are monitored systematically for compliance and to see if they are accomplishing the desired results.**

***Board's response**: The Board accepts the recommendation and has expanded its existing compliance monitoring system to include all NEB approvals of facilities. Although the recommendation is specific to environmental information management needs, we believe there is a significant benefit in the integration of the environmental and safety auditing programs. We will develop by 30 October 1998 an action plan for the complete review of our environmental and safety information needs and an action plan for the development of an appropriate information management system.*

**Need to implement a rigorous safety and environmental risk management framework**

**13.48** Given the NEB's resources, an important question is how much monitoring is enough to fulfil regulatory requirements? Although some external checks and balances on pipeline companies are provided in law and by various watchdogs and vested interests, the NEB has to strike a balance between the need to assess the inherent risks of a pipeline throughout its life cycle and the effective use of the limited resources available for inspection and audit. Risk management provides a framework for making such determinations. We expected that the Board would have a clear policy to provide direction for the cost-effective discharge of its safety and environmental monitoring responsibilities using risk management techniques, and that the work would be planned and resources allocated accordingly.

**13.49** The Board's information bulletin on safety audits indicates that they are conducted every two years for large companies and every four years for other companies. Safety audits review procedures and records of these companies to verify compliance with regulations and to address any safety issues.

**13.50 Safety audit based on subjective assessment.** Due to resource constraints, 40 percent of scheduled safety audits were not carried out in 1997–98. Only companies with the highest safety risks

had been selected for safety audit. However, we understand that the evaluation of safety risk was based on staff knowledge but that no rigorous risk analysis was conducted and the criteria were not validated. For example, data on recent incident trends were not used in selecting audits to be carried out. Based on current scheduling practices, 25 safety audits should have been carried out in 1997–98 but only 15 were conducted.

**13.51** The need to develop risk assessment methodologies was identified as a strategy for 1997–98. This would provide for an audit focus on the companies and activities where the risk of non-compliance or other risks are high and where increased surveillance is thus required. However, the risk assessment methodologies have not yet been developed and are not expected to be completed until the second quarter of 1998–99.

**13.52 Environmental inspection cycles not always followed.** There is no clear policy on the scheduling of pipeline environmental inspections, but the current practice is to conduct periodic inspections: during pipeline construction, post-construction (that is, within three years following construction), and in three- to five-year cycles thereafter during the operational period. Inspections at the post-construction stage are to ensure that restoration measures have been put in place and are effective. This approach has evolved within the Health, Safety and Environment Team and is based on past experience and the availability of resources.

**13.53** The NEB's pipeline inspection regulations require companies to file post-construction environmental reports identifying any issues that arose and indicating how they were resolved. Companies are also required to provide follow-up reports after the next two growth seasons. The NEB relies on the self-reporting of companies and inspects only a limited number of construction sites to verify the accuracy of the reports.

**13.54** The NEB is developing a risk analysis approach toward scheduling and conducting environmental inspections. Recently, its inspection staff dropped from

**The NEB relies on the self-reporting of companies and inspects only a limited number of construction sites to verify the accuracy of the reports.**



*Pipeline construction (see paragraph 13.52).*

three to only one. Only inspections considered to be highest priority have been carried out. NEB staff informed us, for example, that last year they visited only 4 out of 28 potential sites as part of a post-construction inspection.

**13.55** In our opinion, post-construction inspection is not being given the attention it deserves. The condition of the right-of-way after its restoration represents an environmental benchmark against which future changes could be measured and the effectiveness of Board decisions assessed. The Board needs to give this more emphasis in the inspection program.

**13.56 Current environmental inspection practices are too informal.** The NEB introduced two environmental inspection manuals in 1988–89, one for construction and the other for operations. However, the manuals are not used routinely in inspections. Although there are generic lists of environmental concerns to be included in inspections, there are no detailed checklists or audit programs that inspectors are to complete during the various phases to ensure that all required aspects are covered systematically.

**13.57** For three projects that we selected at random for review, NEB staff were unable to find the inspection binders, which are supposed to contain all relevant inspection documentation. Nor could they locate the inspection reports on two of the three projects. We were given various reasons for this, including the misplacement of inspection binders by staff not currently part of the team and improper filing due to the heavy workload. If workload was indeed a contributing factor, we expect the situation to deteriorate further as the number of applications continues to rise along with the number of kilometers of approved pipeline to be inspected.

**13.58 The National Energy Board should:**

- **use a rigorous risk assessment methodology to determine the level of safety and environmental inspections and audits needed to fulfil its legislative responsibilities, and allocate its resources accordingly; and**
- **formalize its environmental inspection procedures and strengthen its documentation practices.**

***Board's response**: The Board accepts the recommendation and, as noted in the chapter, has under way a project to develop a risk assessment tool to assist in the allocation of resources to safety and environmental audits. The project will be completed by 30 November 1998. The NEB will review all of its environmental and safety audit procedures and ensure that they are complete and in place by 31 December 1998. Adherence to procedures will be an emphasis of management. The NEB will increase the resources allocated to its safety and environmental auditing program to replenish those resources lost through attrition or those resources diverted to handle the extremely high applications workload experienced in the past few years.*

## Human Resource Management

**13.59** When the Board moved from Ottawa to Calgary in 1991, it had 310 employees. Only 130 relocated, with the option of returning to Ottawa. Eventually 25 of them did return.

**13.60** More recently, in response to evolving markets and government policies, the NEB has reorganized from a conventional structure into a rational business grouping that emphasizes teamwork and is less hierarchical. The NEB is to be commended for its new approach to organizational structure, even though it is too early to judge the ultimate success of this initiative.

The NEB is to be commended for its new approach to organizational structure.

**13.61** As the NEB started to fit into the Calgary environment and implement its new business structure, it considered

whether it had the right mix of people to meet the new challenges. At the same time, the Board was conscious of the need to remain independent of the industry it regulates and to be objective in its dealings. In 1993, the Board introduced a Code of Conduct to guide its staff. Since its relocation to Calgary, the NEB's human resource management processes have been undergoing revision (see Exhibit 13.6).

**High staff turnover**

**13.62** The NEB views the ability to attract, develop and retain highly skilled staff as one of the important elements in meeting its strategic objectives. The past two years have been especially challenging, partly due to increased activities in, and competition from, the energy market.

**13.63** The NEB's operations are located in a highly competitive market, the Calgary oil patch. It is competing for talent with an industry that has greater salary flexibility, and that may offer staff more attractive career opportunities than a government agency.

**13.64** Since relocating, the NEB has had to hire professional staff to fill vacancies. The NEB has had high staff turnover in the last two years, reaching 18 percent in 1997–98 (Exhibit 13.7); and chronic vacancies have resulted in extra workload on remaining employees. Total human resources have decreased in the last 10 years, but the NEB has always had fewer staff resources than it projected it would need. Elsewhere in this report, we note that the NEB has some operational deficiencies in implementing its safety and environmental mandates, which may be due to a lack of staff with appropriate experience.

**13.65** **Organizational change.** With any radical change, some people are unhappy or unwilling to adapt and this can adversely affect morale and productivity. For example, an analysis of NEB exit interviews revealed that some people saw low pay as a disincentive; others did not like the particulars of the reorganization, even though they seemed to approve of the initiative itself; and others cited low morale. At the same time, some employees spoke positively about job satisfaction, the good working environment and generous training opportunities.

**13.66** While exit interviews may present some bias, they can also give valuable information from which lessons can be learned. The NEB could confirm the validity of exit comments by seeking input from employees who have not left, for example, through its Classification Review and Leadership Training projects. Without a rigorous, documented analysis

The NEB has had high staff turnover in the last two years, reaching 18 percent in 1997–98; and chronic vacancies have resulted in extra workload on remaining employees.

Exhibit 13.6

**Key Changes to NEB Human Resource Management Processes since 1991**

| | |
|---|---|
| **1992** | • gained flexibility as a separate employer in order to compete in the Calgary market |
| **1993** | • implemented a new staff classification plan |
| **1994** | • conducted an employee survey |
| **1995** | • followed up on the survey with a vision implementation project |
| **1997** | • adopted a new accountability framework effective April 1 and reorganized from 10 branches into 5 business units |

Exhibit 13.7

**National Energy Board Employee Activities**

| Fiscal Year | Employees Leaving | Turnover Rate % | Employees Hired |
|---|---|---|---|
| 1994–95 | 40 | 13.4 | 18 |
| 1995–96 | 41 | 14.7 | 34 |
| 1996–97 | 29 | 10.7 | 20 |
| 1997–98 | 49 | 17.7 | 29 |
| **Total** | **159** | | **101** |

Note: Includes retirements, death in service, end of term, transfer out/in, layoff and resignation.

of the views of staff both leaving and remaining, it will be difficult for management to determine conclusively whether staff turnover is caused by factors such as remuneration or by other factors.

**13.67** As staff resource levels have declined, partly by design and partly because of competition factors, the NEB has had to come to grips with a number of human resource challenges. It has undertaken about 20 human resource management projects since 1997. We believe that many of these projects could have been structured better if they had been linked to an overall human resource strategic plan, and if the NEB had set clear goals and objectives for each project.

**Predicting future staffing needs is crucial for the NEB**

**13.68** The NEB has identified key factors that will influence its regulatory program over the next three years, but we have not seen any analysis of the levels and skills it will need in its staff and how it will attract them, considering its resources and staff turnover. Consequently, in spite of new human resource management initiatives, there is a risk that the NEB may be more reactive than proactive, and may lack appropriate resources in the future to deal with new issues. Management has identified a need to develop a human resource strategic planning framework, but at the time of our audit this project had not been started.

**13.69** Management needs to build on its positive initiatives, create better communication to dispel any concerns resulting from the organizational changes, and introduce initiatives that can improve its effort to retain staff. The NEB recognizes this problem and has made some positive changes to try and compete for staff more effectively, given the government environment in which it functions. We noted, for example, the inclusion of some incentive measures in the recent collective agreement signed with its professionals.

**13.70 The National Energy Board should ensure that its human resource management activities are clearly linked to its vision of the future and that its related projects are carried out in accordance with a systematic plan and in response to its operational needs.**

***Board's response**: The Board accepts the recommendation. In the fall of 1998 the NEB will develop clearer context, strategies and expectations for performance. This will provide the environment within which human resource management activities can be more clearly linked to the NEB's vision of the future and enable the development of a systematic human resource strategic plan. A human resource strategic plan will be in place by 1 April 1999.*

## Cost Recovery: Who Pays?

**13.71** Since 1991, the NEB has recovered most of its costs from the companies it regulates, except the costs related to its frontier activities. The regulations identify companies subject to cost recovery on the basis of their size. Small companies are charged an annual fee of $500 and intermediate-size companies $10,000. The remaining costs are charged to large companies based on staff time spent on the regulation of each commodity and according to their relative share of volumes shipped or, for electrical companies, volumes exported.

**13.72** In 1995, a staff working group was established to consider the updating of the Cost Recovery Regulations. Some of its recommendations were reflected in the revised regulations, approved in April 1998. No amendment was made to the cost allocation method, except a minor revision to the calculation of electricity export volumes.

**Are costs recovered equitably?**

**13.73** The cost allocation method has been the same since it was first

introduced. It is based on direct time charged into three commodity pools: gas, oil and electricity. While this is simple to administer, it raises some concerns about fairness, one of the objectives pursued by the government cost recovery and charging policy. For example, we noted that:

- the portion of indirect time charged to commodities remains high, at about 60 percent;

- the NEB costs of processing applications and of hearings are not borne by the applicants but instead are recovered from the existing large companies, based on their respective volumes shipped. The net effect is that existing companies are paying for the cost of processing new applications, some of which may be those of competitors;

- only about 60 percent of direct staff time was spent on large companies in the last three years, whereas 99 percent of the costs are recovered from this group; and

- under the cost recovery regulations, the costs charged for a given year are based on time actually spent in the previous fiscal year, and are not adjusted to reflect current-year actuals.

**13.74 Stakeholders have expressed dissatisfaction with the present cost allocation methodology.** When it assessed the feasibility of cost recovery, the NEB conducted preliminary analyses of allocation methods. The present commodity allocation method was selected over using a detailed fee structure or charging direct time. One industry association commented in 1989 that the Board had settled for simplicity at the expense of cost causality in its decision to use the cost allocation method. The NEB set up a Cost Recovery Liaison Committee to provide a forum for stakeholders and staff to discuss cost recovery issues of mutual concern. Our review of the Committee's minutes indicated that some industry representatives have complained that the current allocation method does not share costs equitably among the regulated companies.

**13.75** In our opinion, the method now used for cost recovery raises questions about equity. As more applications are pending and stakeholders raise concerns about fairness, there is a need to review the present cost allocation method.

**13.76 There is no cost accounting system.** The NEB uses its Time Reporting System to identify the time spent on regulating each commodity, and costs are allocated based on time spent. The NEB does not have a cost accounting system. It is important to know how much it costs to carry out a specific activity, not only for cost recovery but also for management purposes. If data from the Time Reporting System could be merged with data in the current financial system, this might provide an adequate basis for costing.

Some industry representatives have complained that the current allocation method does not share costs equitably among the regulated companies.

**13.77 Cost control versus operational efficiency.** As a government agency, the NEB has been subject to the same budgetary reductions as other departments. Yet the NEB's costs, for the most part, are paid by industry and not from the public purse. Given its growing workload, and the needs of stakeholders for thorough and timely decisions, there may be an opportunity for the Board to discuss a more flexible financial arrangement with the Treasury Board and its other stakeholders to better match its resources with its service needs.

**13.78 The National Energy Board should:**

- **recover its future costs in a more equitable and acceptable manner, to be developed in consultation with the regulated industry; and**

- **develop a cost accounting system so it can identify the costs of processing applications and of other activities, for cost recovery and management purposes.**

***Board's response**: The Board accepts the recommendations, and has already started negotiations with the cost recovery community for a complete review of all aspects of the cost recovery regulations. A recommendation for a new, more equitable methodology will be made by the second quarter of 1999–2000. Also, a review of the financial planning and reporting processes and a redesign of the management information systems are targeted for completion by the end of the fiscal year 1999–2000.*

**Costs of frontier activities are not recovered**

**13.79** In 1991, the Board was given administrative responsibility for overseeing oil and gas operations in frontier regions previously managed by the Canada Oil and Gas Lands Administration (the *NEB Act* was amended in 1994 to authorize this transfer of responsibilities). Responsibilities include regulating oil and gas exploration, development and production; enhancing worker safety; and protecting the environment. Other frontier activities of the NEB include calculating discovered and undiscovered hydrocarbon resources, and developing emergency environmental contingency plans that support and complement the Board's regulatory responsibilities. The total cost to the Board of its frontier activities is more than $4 million annually.

**13.80** The Minister of Energy in 1991 exempted these operations from cost recovery, because they were outside the scope of the Board's normal activities. The cost recovery regulations were modified in 1995 to empower the Board to decide which costs it could recover. In July 1998, the Board decided to continue the exemption of frontier activities from cost recovery, retroactive to 1995.

**13.81** There are three producing fields in the frontier lands. The most significant one consists of 350 wells, a gas plant, oil treating facilities and six artificial islands in the Mackenzie River. Current production annually generates a five percent royalty and a one-third net profit interest for the government amounting to approximately $7.5 million and $50 million respectively. These amounts are collected through an agreement between the federal government and a petroleum company. Although frontier lands are federally owned, the royalty regime appears to be similar to provincial arrangements.

**13.82** The Board has seen its workload as administrator of frontier activities increase since 1994 and it anticipates more frontier activity in the near future. It may be appropriate to take a fresh look at frontier costs. Any future change to allow for cost recovery from the companies active in the frontier lands will need to be accompanied by an amendment to section 24(1) of the *NEB Act*.

## Challenges to Reporting on Performance

**13.83** Unlike companies in the private sector, organizations such as the NEB cannot measure their performance by reference to a conventional bottom-line profit or loss. As a public sector entity, the NEB has to find different ways to demonstrate whether its results meet the expectations of its stakeholders.

**13.84** Traditionally, government agencies have shown how they have spent their budgets but often not what they have achieved. This is changing as entities like the NEB are increasingly challenged to report the results they have achieved. This is particularly appropriate for the NEB, having reorganized itself into a team-based structure focussed on results and having adopted a new accountability framework. Furthermore, the NEB was part of a pilot project in late 1996 to identify and report on its performance for the fiscal year ended 31 March 1996.

**13.85** Our April 1997 Report Chapter 5, "Reporting Performance in the Expenditure Management System", identified five elements needed to give a credible account of performance:

- clear context and strategies;
- meaningful performance expectations;
- accomplishments reported against expectations;
- demonstrated capacity to learn and adapt; and
- fair and reliable performance information.

**13.86** A significant part of the challenge for an organization moving into performance measurement and reporting is the need for visible commitment by senior management. The corporate culture also needs to change, as staff come to accept that different things not previously selected will be measured and reported. Another challenge is to accept and report results that may be less than favourable, and to learn from the experience.

**Need for clear expectations**

**13.87** As organizations adapt to performance measurement and reporting, they need to adopt a multi-year perspective with critical analysis of what has and has not worked, and to be willing to change what has not. Sometimes it is helpful to benchmark an organization against similar entities, both to identify performance measures and to compare relative performance achievements. To improve accountability, it is important that performance indicators be focussed and stated clearly.

**13.88** The NEB has made a good start toward identifying and reporting on its performance. It has developed a Report on Plans and Priorities, backed up by more detailed work plans, that identifies the elements of performance measurement, including performance indicators. But it will need to review its progress critically, and adapt in a number of areas. First, it needs to set clear performance expectations. Second, it needs to harmonize them between its plans and priorities document and its Performance Report. Third, it needs credible reporting of its actual performance.

**13.89** The NEB's performance indicators still focus more on activities and outputs than on outcomes. The 1998–99 Report on Plans and Priorities identifies 44 performance indicators. It would be preferable to identify fewer indicators that can be linked directly to outcomes of the organization. This would provide for a more in-depth analysis of its performance. When selecting indicators, it is important to keep in mind that information for performance reporting needs to be of value internally as well as effective for external accountability.

**13.90** Currently, some of the NEB's performance indicators change from year to year. Although performance indicators may evolve over time, if the NEB decides to change them it ought to be able to demonstrate why, and provide some continuity in its documents for the purpose of assessment.

**13.91** In the 1997–98 Report on Plans and Priorities, the "expected results" could correspond better with the "strategies" to be used to achieve them. Presently, it is unclear how the expected results will be achieved or measured. Additionally, the 1996–97 Performance Report did not restate previous performance expectations; it noted only some direct outputs of the organization. A stronger link between the NEB's stated expectations and the results it has achieved would result in a more useful performance report for accountability purposes.

**Reporting results achieved**

**13.92** The NEB will need to change its culture to fully embrace performance reporting. It has no system developed to

The NEB will need to change its culture to fully embrace performance reporting.

track results against objectives, or to report periodically to its Executive with suggestions for change. Performance measurement and monitoring in a results-oriented organization needs to be an integral part of management. For performance measurement and reporting to continue to be a positive and productive process, it is important that the NEB monitor its performance strategically, regularly and consistently.

**13.93** Preparation of the NEB's annual Performance Report is delegated to a staff person in Finance, who has to try to obtain information from the teams and co-ordinate it in some meaningful way. It would be preferable for each business unit to have a Performance Report co-ordinator, who can track results regularly and meet periodically with counterparts in other units and the NEB performance reporting facilitator to consolidate the information for internal and external reporting.

**13.94** With a designated person in each unit, the NEB could have better assurance that the data are accurate and meaningful. For example, we noted that the 1996–97 Performance Report presented a comparison of application cycle times for the years 1995 and 1996. The report did not mention that the comparison excluded the time between receipt of the application and the Board's issuance of directions on procedures. This represented about 10 additional weeks (see Exhibit 13.8). Incomplete information does not provide a reasonable basis for accountability and could prove embarrassing to the NEB.

**13.95** It is important that the NEB continually compare performance accomplishments against expectations. We encourage it to have each business unit produce a "Best Practices Review", as the Applications Business Unit does, to learn from experience and improve performance measurement and reporting.

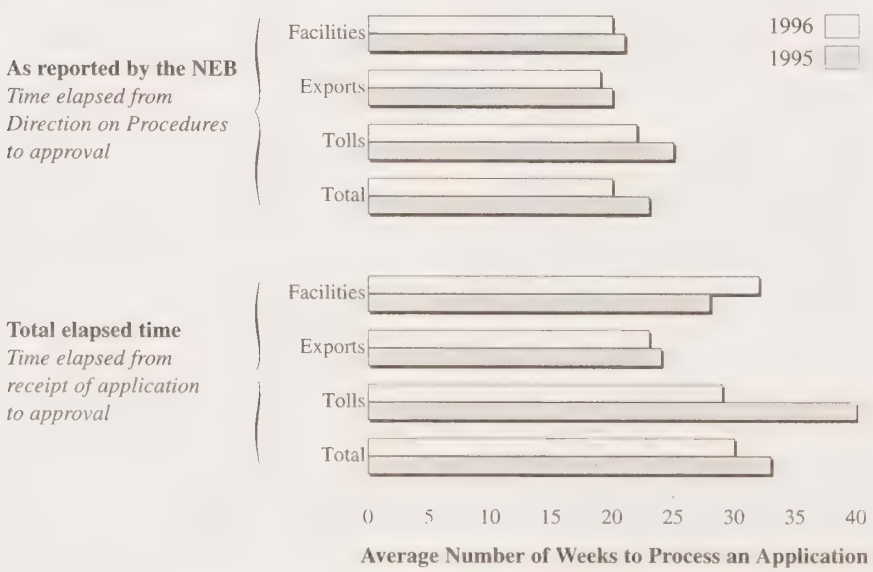
**13.96** **Linking costs to results.** The Treasury Board Secretariat guidelines suggest that key performance accomplishments linked to expectations, mission statements and objectives should include the important aspects of results achieved, and their costs.

**13.97** However, the NEB's 1996–97 Performance Report does not identify the costs and other financial information associated with performance. Although it reports by activity on planned spending compared with actual spending, the NEB

**Exhibit 13.8**

**Comparing Measurement of Cycle Times**

Large Pipeline Only



needs to include an explanation of where and why it overspent or saved. It could then demonstrate more effectively how actual results compared with those originally expected.

**13.98 As it continues its efforts to manage for results, the National Energy Board should:**

- **improve the clarity of its expectations;**
- **monitor its performance regularly and make adjustments as needed;**
- **state clearly the results it has achieved and at what cost; and**
- **designate a co-ordinator for each business unit to monitor key performance indicators.**

***Board's response**: The Board accepts the recommendations. The Board recently hired a team leader for planning and reporting, who has started a review of financial planning and reporting processes and is designing a training program for users of the management information systems. A new individual performance management process called "FOCUS" was introduced in April 1998, and a strategic planning process will be started in September 1998. These are seen as critical first steps to both increase the individual's and the organization's performance and improve the processes to report on that performance.*

## Audit and Evaluation

**13.99** Program evaluation and internal audit are valuable management tools in assessing whether programs are still relevant and cost-effective. In the past two years, the NEB has planned 12 internal audits but carried out only five. No evaluations have been conducted since 1994, and it has been at least eight years since important areas such as exports and imports, pipeline facilities applications, safety, and tolls and tariffs were reviewed. Audit and evaluation budgets have declined from 1.7 percent of expenditures four years ago to about 0.3 percent now.

**13.100** The Audit and Evaluation unit consists of only one person. Given that some planned audit work has not been carried out and that even the small budget has not always been used, one could question whether the Executive sees this function as adding value to the NEB and whether it is prepared to use it as a key management tool.

### Need for an evaluation

**13.101** With its role evolving in response to changing market conditions, the NEB needs to be able to answer critics who question whether it is still relevant and effective. Once seen as the guardian of Canada's energy security, the Board now approves exports conditional on Canadian access at competitive prices. Operational changes have preceded legislative amendments, and with the advent of NAFTA the role of the Board has become more oriented toward business. New responsibilities have emerged in the safety and environmental areas. In this climate of significant change, the NEB would do well to commission an evaluation to assess the effectiveness of its program and its continued relevance.

**13.102 The National Energy Board should reinforce its audit and evaluation function and commission an evaluation.**

***Board's response**: While the Board was initiating a profound business transformation and reorganization over the last two years, we chose to limit the number of internal audit projects. Now that we have moved to the implementation of our Vision and the rate of internally generated change has gone down, we agree that we ought to reinforce our audit and evaluation function. The NEB will adopt an explicit audit and evaluation program by 1 April 1999.*

*The Board also agrees that the time has come for an evaluation of the program's effectiveness. The NEB will consult with*

*our stakeholders, including the policy arm of government, to determine the value of an evaluation of the program's continued relevance. We undertake to determine the scope of the evaluation and its timetable by 1 April 1999.*

## Conclusion

**13.103** In the areas we examined, the National Energy Board has adapted its regulations and processes to the changing energy market. In our opinion, however, the NEB needs to improve some of its management processes and operational practices to minimize the risk of being unable to fulfil its regulatory obligations and cope with the challenges ahead. The NEB needs to reassess its current level of resources and determine whether they are appropriately allocated to do the job cost-effectively. We also believe that it needs to undertake an evaluation to assess the effectiveness of its program and the extent to which it continues to be relevant.

# About the Audit

## Objectives

Our overall audit objective was to assess whether the National Energy Board was fulfilling its obligations as a regulatory body in the areas subject to examination, and specifically whether it has:

- identified changing circumstances;
- used appropriate surveillance and enforcement methods;
- developed effective management interfaces with other jurisdictions;
- established efficient and cost-effective operations and cost recovery practices; and
- carried out appropriate monitoring and reporting of operations and managerial performance.

## Scope

We examined key management and operational processes, including:

- human resources management;
- financial surveillance of tolls and tariffs;
- cost recovery;
- performance measurement and reporting;
- environment and safety audits and inspections;
- pipeline accident investigations; and
- internal audit and evaluation.

## Criteria

We developed criteria related to our audit objectives, which were discussed and agreed to by management.

## Audit Team

Assistant Auditor General: Don Young
Principal: Roger Simpson
Director: Jean-Pierre Plouffe

Christopher Keith
Martha Lywak
Werner J. Müller-Clemm
Geoffrey Robins
Donna-Lee Shaw
James Van Horn
Peter Yeh

For information, please contact Roger Simpson.

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# Report of the Auditor General of Canada to the House of Commons

## Chapter 14
Indian and Northern Affairs Canada –
Comprehensive Land Claims

**September 1998**

Report of the

# Auditor General of Canada

to the House of Commons

**Chapter 14**

Indian and Northern Affairs Canada –
Comprehensive Land Claims



**September 1998**

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# Chapter 14

## Indian and Northern Affairs Canada

### Comprehensive Land Claims

*The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.*

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# Indian and Northern Affairs Canada

## Comprehensive Land Claims

## Main Points

**14.1** Comprehensive land claim settlements are modern treaties that are significant not only to Aboriginal communities but also to all Canadians. Settlements involve the payment by the federal government to Aboriginal groups of almost two billion dollars and the clarification of various rights, including full ownership of over a half-million square kilometres of land. The first modern negotiated settlement of a comprehensive land claim was signed in 1975, and the most recent settlement was reached in July 1997. As of July 1997, 12 claims had been settled. Actual and potential claims involving over 200 First Nations are still to be settled.

**14.2** The Government of Canada has chosen to settle these claims by negotiation rather than litigation or other means. Indian and Northern Affairs Canada is the lead federal representative in negotiations, with participation of other federal departments as appropriate. Other parties include the territorial governments, provincial governments, and the claimants. Although the Department bears significant accountability for results, it is not the only party that should be accountable; the good will and political resolve of all participants are needed in order to achieve appropriate settlements.

**14.3** The government has reported that negotiated settlements establish certainty to land title and access to land and resources. However, removing uncertainty involves much more than signing an agreement. Among other things, successful implementation of settlements is critical to achieving the intent of these treaties. Implementation involves hundreds of projects with joint or separate participation of the parties. We found deficiencies in implementation, including inadequate or non-existent implementation plans, and the need to improve monitoring, reporting and evaluating.

**14.4** Indian and Northern Affairs Canada has not demonstrated that it has always exercised adequate rigour in determining the nature and amount of assets that may ultimately be included in final settlements, including such considerations as the amounts of cash, land and other resources.

**14.5** Settlements can take over 20 years to reach. Delays have had many causes. In our view, these long time frames do not contribute to cost effectiveness, and may result in less desirable outcomes for all concerned.

## Introduction

**Comprehensive land claims — What are they?**

**14.6** The Government of Canada describes comprehensive land claims as claims relating to ongoing Aboriginal title to land and rights that have not been dealt with by treaties or law. At issue are Aboriginal assertions that their rights have been disregarded, that such rights are guaranteed by the Constitution (1982), and that claim settlements are needlessly slow and do not provide sufficient compensation, land and recognition of rights. We note the importance of land in Aboriginal culture and its relevance to inherent rights of self-government. Another category of claims, specific claims, deals with alleged treaty violations and related matters; these are not the subject of this audit.

**14.7** Settling comprehensive land claims involves negotiating and implementing complex, modern treaties. According to the Department, claim settlements act as a springboard for First Nations self-government and may include concurrent or subsequent development of self-government agreements.

**14.8** The transfer of ownership of and rights to large tracts of land and resources and the payment of substantial amounts of money to Aboriginal communities are usually the major features of a claim settlement. Benefits to the claimants can include participation in resource management, including water, wildlife, and subsurface and offshore assets, and in resource and revenue sharing.

**14.9** Among other things, the government believes that negotiated settlements avoid litigation against it, thus resolving the legal ambiguities associated with the common-law concepts of Aboriginal rights. According to the government, settlements exchange undefined rights for explicit rights under the agreements.

**Significance of land claim settlements**

**14.10** The first modern comprehensive land claim settlement was reached in 1975 and, as of May 1998, the most recent settlement had been in July 1997. The geographic areas covered by settled and unsettled comprehensive land claims include most lands in the territories, most of British Columbia, a significant area of Quebec and smaller areas in other parts of Canada.

**14.11** As of July 1997, 12 claims, including six under an umbrella claim by 14 First Nations, had been settled. These involved 48,000 Aboriginal people, full ownership of over a half-million square kilometres of land, a financial package totalling $1.8 billion and other considerations. Details are set out in Exhibit 14.1. Implementation of the agreements continues and payments will continue until at least 2012. The Department plans to spend $262 million on comprehensive claims in 1998–99, although it does not clearly disclose in its Estimates to Parliament the amounts for negotiating them, for implementing them and for making payments under them.

Land rights and financial components are key elements to a settlement.

**14.12** As of June 1998, there were 70 claims in various stages of negotiation and pre-negotiation discussion, or with accepted statements of intent to negotiate, including 52 in British Columbia and 18 outside B.C. There are 123 bands who have registered their intention to proceed under the British Columbia Treaty Commission process.

**14.13** During the summer of 1998, steps toward the completion of the Nisga'a Treaty in British Columbia were being finalized outside the British Columbia Treaty Commission process. Since the treaty was in final negotiation at the time of our audit, we did not review how it was reached or the results achieved.

### Parties to a claim and the claims process

**14.14** Under the best of circumstances, reaching comprehensive land claim settlements is a very difficult challenge. Parties to a claim generally include the federal government, territorial or provincial governments and the claimant Aboriginal groups. Each party to a settlement agreement accepts rights and responsibilities either jointly or separately under very complex and voluminous agreements.

**14.15** Final settlements can take more than 20 years to reach. This is partly because of the number of parties involved and the complexity of the claims. In addition, the motivation and the negotiation strategies of the parties can directly affect the speed, cost and content of settlements.

Exhibit 14.1

**Selected Features of Settled Comprehensive Land Claims**

| | Date of Final Agreement | Settlement Amount Federal Share[1] ($ millions) | Settlement Land[2] (sq. km.) | Settlement Beneficiaries[3] |
|---|---|---|---|---|
| James Bay and Northern Quebec | Nov. 1975 | 35 | 14,000 | 18,100 |
| Northeastern Quebec | Jan. 1978 | 1 | 326 | 600 |
| Inuvialuit | June 1984 | 170 | 91,000 | 2,500 |
| Gwich'in[4] | Apr. 1992 | 75 | 23,976 | 2,200 |
| Nunavut | May 1993 | 580 | 351,000 | 19,500 |
| Yukon First Nations[5] | | | | |
| Champagne and Aishihik | May 1993 | 28 | 2,396 | 678 |
| Nacho Nyak Dun | May 1993 | 15 | 4,740 | 434 |
| Teslin Tlingit | May 1993 | 19 | 2,396 | 512 |
| Vuntut Gwitchin | May 1993 | 19 | 7,744 | 432 |
| Little Salmon/Carmacks | July 1997 | 16 | 2,590 | 484 |
| Selkirk | July 1997 | 17 | 4,740 | 469 |
| Sahtu Dene and Metis | Sept. 1993 | 75 | 41,437 | 2,288 |
| **Total** | | **1,050** | **546, 345** | **48,197** |

**Notes:**

[1] The amounts are expressed in net present value at the time of settlement, except the James Bay and Northern Quebec and Inuvialuit agreements, which are in current dollars. The total amount payable in current dollars by the federal government for capital transfers is $1.8 billion, which includes interest where applicable.

[2] This land is full ownership land in accordance with the agreement. Agreements also provide for various rights respecting other lands.

[3] Population is the most current estimate available.

[4] 22,422 sq. km. in Northwest Territories and 1,554 sq. km. in Yukon.

[5] Numbers in exhibit are 6 out of 14 First Nations in Yukon. For all 14, the umbrella total settlement amount is $242.7 million and 41,440 sq. km.

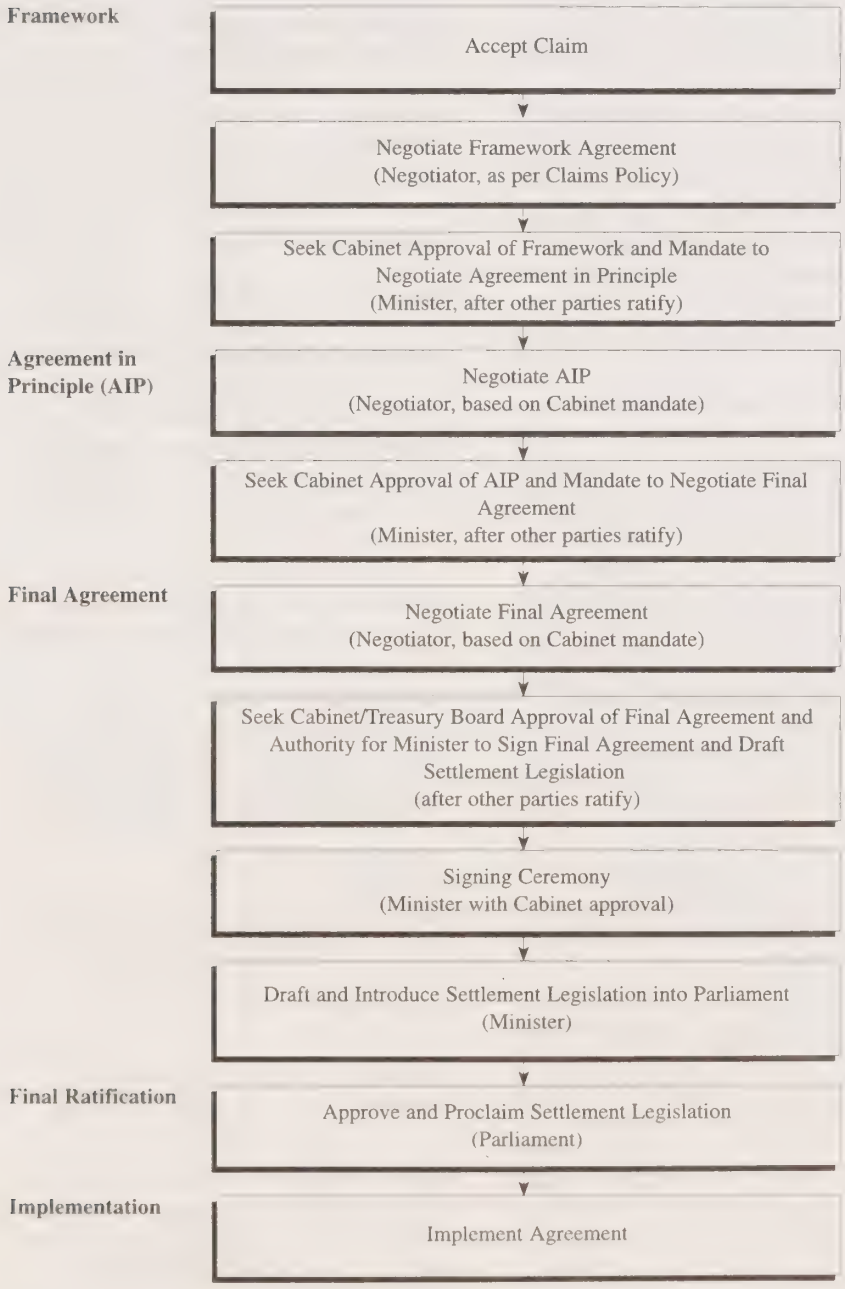
**Source:** Indian and Northern Affairs Canada and Final Agreements

**14.16** Although the Parliament of Canada has jurisdiction in matters relating to Indians and lands reserved for Indians, co-operation in settling claims is needed from the territorial and provincial governments with respect to certain lands that fall under their jurisdiction. For example, most treaties in British Columbia are addressed through the British Columbia Treaty Commission, established by the governments of Canada and British Columbia and the First Nations Summit.

**14.17** The claims process outside of British Columbia, as set out in Exhibit 14.2, begins with research and submission of a claim by the claimant

**Exhibit 14.2**

**Summary of Comprehensive Land Claims Process**




**Source:** Indian and Northern Affairs Canada

Current claims policy and objectives were developed in 1986.

group(s), followed by its validation by government and then negotiations for settlement. The federal government is represented by Indian and Northern Affairs Canada as the lead department, with participation by the Department of Justice and other departments as appropriate.

**14.18** Claims are negotiated by negotiating teams with various working groups and committees. Major events in the process include reaching a framework agreement to establish the scope of negotiations, reaching an agreement in principle that sets out, among other things, the financial amounts and land, and reaching the final settlement agreement and implementing it. The importance of claims settlements is further signalled by Cabinet's approval of negotiating mandates and by settlement legislation.

### Comprehensive land claims policy and objectives

**14.19** The evolution of claims policy and objectives has been greatly influenced by jurisprudence. In the *Calder* case in 1973, the Supreme Court of Canada acknowledged the existence of Aboriginal title in Canadian law. According to the Department, this decision and other jurisprudence, reviews and ongoing claims negotiations between 1973 and 1985 set the stage for rethinking the federal government's position on comprehensive land claims. The current claims policy and objectives were developed during this period and were published in 1986.

**14.20** The policy objectives state:

> The purpose of settlement agreements is to provide certainty and clarity to ownership and use of land and resources in those areas of Canada where Aboriginal title has not been dealt with by treaty or superseded by law. Final settlements must therefore result in certainty and predictability with respect to the use and disposition of lands affected by the settlements. When the agreement comes into effect, certainty will be established as to the ownership rights and the application of laws.

**14.21** Settlement agreements contain surrender provisions pertaining to certain Aboriginal rights. For example, a 1993 final agreement states that the First Nation and the people eligible to be represented by it cede, release and surrender to her Majesty all their Aboriginal claims, rights, titles and interests in and to non-settlement land and all other land and water within Canada, with some exceptions. The government sees this as a means of removing uncertainty that is deemed to be a barrier to economic development.

**14.22** Pressures on claims and claims policy persist. A notable example is the *Delgamuukw* case in which 58,000 square kilometres of northwestern British Columbia were claimed. The case commenced in 1984 and was ultimately decided by the Supreme Court of Canada in December 1997.

**14.23** The Supreme Court did not render a decision on the claimed land. However, it further defined the scope of Aboriginal title and related rights and stated that oral evidence pertaining to the acceptability of the claim should have been more liberally accepted at trial. The Court also ordered that a new trial be held if a negotiated settlement could not be reached. Aboriginal groups have considered this decision as support for their interests, and the government has indicated that it will be exploring the implications of the decision with the parties.

### Fairness of the claim settlement approach

**14.24** Comprehensive land claims negotiations can be adversarial. For example, First Nations have attempted to advance their positions by using the courts and other approaches. The difference

between the financial, technical and legal resources available to the federal government and those accessible to communities of a few hundred or a few thousand Aboriginal people can be substantial. Given that the Crown holds the claimed land, it is important that the approach used to resolve such claims is seen to be fair, objective and credible.

**14.25** We found that for settled claims the approach was largely controlled by the federal government. It decided what criteria would be applied for accepting claims and how much funding would be provided to the claimants to research and negotiate their claims. In addition, the government's policy set out the framework for reaching and implementing settlements.

**14.26** In pursuing its objectives, the government needs to fairly represent all Canadians, who are ultimately bound by the agreements reached. Concurrently, the government has certain responsibilities and obligations for First Nations that do not apply to other Canadians in general. Because the need to balance diverse interests in settling land claims poses a difficult challenge, it may be optimistic to expect all parties to conclude that the process and outcomes were fair.

### Focus of the audit

**14.27** This audit focussed on the role of Indian and Northern Affairs Canada in reaching and implementing comprehensive land claims settled up to July 1997. It took into account that achieving appropriate results requires the good will and resolve of all parties involved. Further details on the audit objective, scope, approach and criteria are found at the end of the chapter in the section **About the Audit**.

## Observations and Recommendations

### Achievements and Results

#### Establishment of certainty

**14.28** Since 1975, the government has finalized 12 comprehensive land claim settlements. The Department's 1998–99 Plans and Priorities Report tabled in Parliament states that negotiated settlements establish certainty to land title and access to lands and resources, avoid time-consuming litigation and create a climate that fosters economic development. Reaching a treaty is viewed by the Department not as an end in itself, but rather as a beginning in which Aboriginal people start to regain control of their destiny.

**14.29** We noted that settlement agreements address, among other things, ownership of land. The importance of claim settlements to Aboriginal peoples and government can be demonstrated by the scope of an existing mature settlement. The agreement provides for the implementation of challenging responsibilities, as shown in Exhibit 14.3.

**The claims process needs to be fair, objective and credible.**

**Exhibit 14.3**

**Examples of Areas Covered by Claim Settlements**

| Lands and Resources | Building Self-sufficiency |
|---|---|
| • surface and subsurface resources | • financial component |
| • wildlife and fish management | • resource and revenue sharing |
| • inland waters | • economic development measures |
| • offshore interests | • training |
| • general management rights | • political, social and cultural interests |
| • third-party interests | • self-government |
| • presettlement rights | |
| • environmental management | |

**Source:** Office of the Auditor General of Canada

Reaching a treaty is only the beginning.

**14.30** We recognize that certainty can mean different things to different parties. And, without a consensus on interpretation, it becomes more difficult to determine what exactly is being achieved through negotiated settlements. The risk is that the parties may have agreed on the negotiated outcomes, but have different views on and expectations of the benefits and obligations set out in the signed agreements.

**14.31** We believe that the parties must consider that a strict technical or legal interpretation of certainty may not be sufficient if they wish to reach and implement settlements in harmony.

**14.32** After its 1981 review of its policy, the Department noted that Aboriginal groups continued to be dissatisfied with the policy. In particular, claimants objected to a policy that they believed attempted to extinguish Aboriginal rights in exchange for specific benefits provided under a settlement agreement.

**14.33** Notwithstanding these concerns, settlement agreements have continued to contain extinguishment or surrender clauses pertaining to Aboriginal rights such as hunting, fishing and trapping. Aboriginal groups have continued to assert their rights, as they believe that surrender clauses extinguish their identity, beliefs and way of life. We do not judge the merits of such assertions but note that they can affect certainty from a practical standpoint, such as investor confidence in the areas in question.

**14.34** Moreover, certainty and intended benefits are contingent not only upon unanimity of intent but also on post-settlement events. This is because settlement agreements typically comprise hundreds of pages of terms and conditions that may be interpreted differently by the numerous parties after the agreements are finalized.

**14.35** In addition, even where there is a consensus on interpretation, the implementation of the agreements by all parties to their satisfaction is crucial to fostering the effective relationships necessary for success.

**14.36** While implementation in good faith may be considered a normal expectation, we noted lawsuits against the Crown because of alleged implementation failures and disputes over interpretation of the agreements. The section on implementation disputes elaborates on these claims.

**14.37** Litigation against the government can arise in a variety of circumstances, and is not unique to matters relating to comprehensive land claims. Nevertheless, litigation can compromise the establishment of certainty through negotiated settlements.

**14.38** In 1994, the Minister of Indian Affairs and Northern Development ordered a major study on surrender and certainty issues affecting the negotiation of land claim agreements. The study report, by a senior jurist, was issued in 1995. Among the many discussions on certainty, it noted, "there is certainty when both sides are happy with the result." A number of observations raised in the study are set out in Exhibit 14.4.

**14.39** The report emphasizes that explicit recognition of Aboriginal rights needs to be included in any treaty, and concludes that certainty can be achieved without the surrender of rights provisions contained in recent settlement agreements.

**14.40** The Department confirms that it is committed to the exploration of possible methods, other than the surrender or extinguishment of Aboriginal rights or Aboriginal title, that would provide clarity, stability and certainty through comprehensive claims settlements. Those methods would need to be supported by federal and provincial governments, First Nations and the public.

**14.41** We expected to find valid studies on economic benefits, suggested by the claims policy, that resulted from settlements reached many years ago. This information would be necessary to demonstrate the advantages of and accountability for achieving the objectives, consistent with the enormity and importance of such settlements.

**14.42** The Department provided four study reports on land claims and economic interests reported in 1990 (two reports), 1995 and 1996. They relate to British Columbia, where no final settlements have been reached. One report attempts to place an economic value on uncertainty. It discusses the cost of not settling land claims in specific sectors of the B.C. economy. The other reports identify the perspectives of selected third parties and describe potential benefits of settling claims.

**14.43** The Department has not carried out studies on the benefits of settlements reached in the mid-1970s and '80s in the far North and other parts of Canada. Accordingly, we believe that the Department has not done enough to demonstrate the deemed benefits relating to the economic impacts of negotiated settlements.

**Other factors affecting results**

**14.44** Many factors can affect the achievement of certainty. For example, the preparedness of First Nations to discharge their responsibilities under settlement agreements is not uniform. We obtained from the Department a sample of management and accountability self-assessments by First Nations who were either considered ready to negotiate a claim settlement or had reached one. The assessments revealed deficiencies in the capacity of a number of First Nations to manage their affairs, including funding arrangements with the government. In our view, such deficiencies do not augur well for reaching and implementing claim settlements. In at least two claim settlements, the parties have recognized the need for implementation training.

**14.45** Overall, we conclude that the establishment of certainty through these agreements may remain elusive in the practical sense.

**14.46 To help enhance the achievement of certainty, Indian and Northern Affairs Canada should further address differing expectations of the**

Exhibit 14.4

Some Observations on the Question of Certainty

- In a narrow legal sense, it may be that certainty was achieved by the surrender and extinguishment of Aboriginal rights. However, in the broader sense of surrender, Aboriginal people consistently maintain their position that treaties were/are not intended to extinguish Aboriginal title. Historical research confirms this was the Aboriginal understanding when treaties were entered into. Further, Aboriginal people can be expected to seek relief from "extinguishment" concessions through litigation, notwithstanding the surrender language in treaty documents.
- The continuing litigation of claim settlement agreements indicates that certainty in the broad, not necessarily the legal, sense of acceptance and common understanding has not been achieved. Whatever common understanding there may have been starts to disintegrate after an agreement is struck. That is, each party sees in the agreement what it had intended to gain rather than what was finally agreed upon.
- For many Aboriginal people, the certainty that is sought is the assurance that treaties (agreements) will be implemented and their rights and benefits respected.
- Several non-parties to settlement agreements believe that certainty cannot always be absolute. In their view, the problem is to define certainty in the relationship with Aboriginal people as a basis for planning and carrying out activities.

**Source**: 1995 Report of Hon. A. C. Hamilton

**parties relating to rights, capacity and implementation needs.**

## Reaching a Settlement

The Department needs to demonstrate adequate rigour in reaching settlements.

### Accepting and validating a claim

**14.47** According to the Department, the criteria applied to decide the acceptability of a claim for negotiation, as set out in Exhibit 14.5, were derived from common-law tests that determine continuing Aboriginal rights. In this regard, the Department relies on the Department of Justice to provide appropriate legal advice. These interpretations and their applications were not included in the scope of this audit.

**14.48** The Department is considering possible implications for the current claims policy and approach to settlements as a result of the December 1997 Supreme Court decision in the *Delgamuukw* case.

### Establishing financial amounts, land transfers and other considerations

**14.49** Major components of settlement agreements include financial amounts, transfer of ownership of and rights to land, resources and other benefits. We sought to determine whether appropriate information and a reasonable approach were used by Indian and Northern Affairs Canada to arrive at the selected components in the agreements.

**14.50** Land claim settlements are the product of negotiations that usually involve a redistribution of significant assets, including land, cash and income from resource exploitation, previously held by the Crown on behalf of all Canadians.

**14.51** Indian and Northern Affairs Canada needs to use adequate information and a suitable approach in determining the nature and amount of assets that may ultimately be included in final settlements. For example, information on the existence and potential value of surface and subsurface resources would be important, in our view, for the Department to use. And, due consideration of alternative approaches would be expected. However, the Department has not demonstrated that it has always exercised adequate rigour when making such determinations.

**14.52** We noted that questions or concerns were raised within the Department about how settlements were being reached. For example, with respect to a number of settlements, the Department did not have studies of the claimed lands that it believed were reliable, land allocations did not take into account the impact of transferring such land, and the determination of resource royalty sharing was done without the use of detailed data on resource potential.

### Relations with the Department of Justice

**14.53** We found that the Department of Justice often raises issues to be addressed by Indian and Northern Affairs Canada during the settlement of a claim. We

**Exhibit 14.5**

**Criteria for Accepting a Claim**

- The Aboriginal group is, and was, an organized society.
- The organized society has occupied the specific territory over which it asserts Aboriginal title since time immemorial, and the traditional use and occupancy of the territory must have been sufficient to be an established fact at the time of assertion of sovereignty by European nations.
- The occupation of the territory by the Aboriginal group was largely to the exclusion of other organized societies.
- The Aboriginal group can demonstrate some continuing current use and occupancy of the land for traditional purposes.
- The group's Aboriginal title and rights to resources have not been dealt with by treaty.
- Aboriginal title has not been eliminated by other lawful means.

**Source:** Indian and Northern Affairs Canada

expected the Department to follow the advice of Justice or, alternatively, provide valid reasons when such advice was not followed.

**14.54** For example, we observed one case where Justice had noted a number of outstanding issues within six months of the agreement signing date. According to Justice, the issues could not be resolved at the legal review stage because of disagreement between the claimants and the government, disagreement between Justice and federal negotiators, apparent time pressure to initial the final agreement, and the desire to maintain comparability with previous land claim settlements.

**14.55** The Department of Justice further observed that while these matters would not cause it to oppose ratification by government of the agreement, it believed that the imminent final agreement was not as clear as it should have been. We noted that approximately two years after the agreement was signed, the claimant party filed a lawsuit against the government on one of the significant outstanding issues. The case was still in litigation at the time of our audit.

**14.56** We were unable to determine if the above-noted case was an isolated one or if other concerns raised by Justice on claims are routinely and appropriately addressed before settlement agreements are signed. However, we were advised by Indian and Northern Affairs Canada that it would not support a settlement proposal if the Department of Justice had any significant, unresolved concerns.

**14.57** We also noted that Indian and Northern Affairs Canada does not request an overall assessment from the Department of Justice on the final settlement before it is signed. We believe that such assessments are necessary to enhance the accountability of the federal parties and to reduce the risk that unintended interpretations of the terms of the agreements could be made.

### Time cycle to finalize an agreement

**14.58** Reaching a final settlement agreement is generally a lengthy affair that can take over 20 years. However, there is no proven guideline that suggests an optimum time frame in which a settlement can best be reached. This leaves only the perception of reasonableness by the parties and non-parties to a settlement as a possible indicator of whether the time taken is acceptable.

**14.59** As a result of a court action by First Nations and related events in 1972, negotiations commenced in 1973 to settle two claims that were finalized in 1975. These were the first negotiated modern comprehensive land claim settlements and took the least time to reach a final agreement. Examples of other settlement time frames are set out in Exhibit 14.6.

**14.60** As indicated in the exhibit, the time taken to reach 10 of 12 settlements

- A claim submitted in 1973 and revised and resubmitted in 1977 was accepted for negotiation in 1978; settlement was reached in 1993.
- Combined claims from five Aboriginal groups were accepted for negotiation in 1976 and 1977. In 1990 a final agreement was reached; however, three of the groups later withdrew from this agreement and their claims are still outstanding. Final settlements were again reached with the other two groups in 1992 and 1993, using the failed 1990 agreement as the basis for negotiations.
- A claim submitted in 1977 was accepted for negotiation in 1978 and settlement was reached in 1984.
- A joint claim from 14 First Nations was submitted and accepted for negotiation in 1973. Settlements were ultimately reached with four First Nations in 1993 and with two more in 1997. Settlements with the remaining eight First Nations are still outstanding.

**Exhibit 14.6**

**Examples of Land Claim Settlement Time Frames as of May 1998**

**Source:** Office of the Auditor General of Canada

The time taken to reach treaties can exceed 20 years.

ranged from 6 to 24 years (with most over 14 years) after a claim had been accepted for negotiation. Moreover, settlements with eight First Nations will take more than 24 years to settle. Three additional claims that had been accepted for negotiation in the 1970s are still unresolved.

**14.61** In 1986 the Department acknowledged concerns in its claims policy about the lack of progress in negotiations. Further, in 1998 a major Aboriginal organization indicated that settlements take much too long to reach.

**14.62** We acknowledge that the reasons for protracted settlements are complex and can be attributed to all parties to a claim, although we do not attribute them to any individual party. Reasons may include the lack of willingness by some jurisdictions to recognize a claim, the nature of the parties' negotiating strategies, the need to meet political objectives, the concurrent connection to self-government negotiations, and the possible impact of non-party interests.

**14.63** However, the way in which the claims process is managed can also contribute to protracted settlements. In some settlements, we noted the following deficiencies:

- There was no overall plan at the beginning of the process that identified the responsibilities of the parties, including other federal departments, and specified target dates for key events, against which progress could be measured.
- Final settlement deadlines were either not set or not met.
- Established procedures for federal and territorial parties were not always followed and negotiations deviated from established mandates, according to departmental information.

**14.64** In our view, protracted settlements do not contribute to cost effectiveness and may result in less desirable outcomes for all concerned. In addition, the benefits of expected economic development in the disputed areas may be delayed.

**14.65 Indian and Northern Affairs Canada should:**

- **ensure that adequate rigour is always applied in determining the nature and amount of assets that are included in final settlements;**
- **obtain an overall assessment of the intended agreement from the Department of Justice before the government signs it; and**
- **together with the other parties to a claim, expedite the claims settlement process, in a cost-effective way.**

## Implementation of Settlement Agreements

### Responsibilities of the parties

**14.66** We believe that a settlement agreement alone should not be considered a successful resolution of a claim unless it is implemented in a cost-effective way. To help achieve this as well as accountability for results, the responsibilities of the parties need to be clearly detailed in the agreements. Furthermore, clear, comprehensive and agreed-upon implementation plans must be developed and used appropriately.

**14.67** Settlement agreements are complex, lengthy documents involving several parties and long time spans. Responsibilities of the parties may be joint or separate and Indian and Northern Affairs Canada, as the lead department, is the project manager for hundreds of obligations.

**14.68** Although the Department is actively involved in the implementation of settlement agreements, we observed the need for improvement. In some cases, the provisions in recent settlement agreements can lead to implementation disputes. For

example, a standard definition in several agreements states that government means the Government of Canada, the territorial government, or both, depending upon which government or governments have responsibility from time to time for the matter in question. This wording, coupled with the ongoing devolution of departmental responsibilities to the territories, increases the risk of ambiguity in implementation responsibilities.

**Implementation plans**

**14.69** We noted that settlements reached prior to 1986 and still being implemented have only partial implementation plans or none at all. For example, an implementation plan for a settlement reached in 1975 was not completed until 1990, and it covers only one of two claimants to the settlement. In another case, settled in 1984, no implementation plan has been developed. The lack of comprehensive implementation plans makes it more difficult to determine progress and to identify problem areas as well as achievements.

**14.70** Agreements reached after 1986 require implementation plans. The plans identify hundreds of implementation projects and activities in varying degrees of detail. In many cases, these projects are contingent upon other events that do not have designated time frames.

**14.71** Implementation plans are attached to the agreements but are not part of them. With some exceptions, they are not intended to be contractual obligations. Consequently, although the plans are signed by the parties, their contribution to accountability and results is limited. According to the Department, the plans are only a guide because flexibility is needed. Given the significance of the land claim settlements and the difficult challenges to their successful implementation, we believe that implementation plans can and need to be more than a guide, while still providing the necessary flexibility.

**Monitoring, reporting and evaluating**

**14.72** The Department uses various methods to monitor and report on implementation. One important method is the Land Claim Obligation System (LCOS) used by the Department to report the status of federal obligations. We found that LCOS is too general to be useful in assessing the status of certain obligations. In addition, LCOS tracks only activities and processes, not results produced and costs incurred.

**14.73** As well, the matching of the obligations contained in settlement agreements to the implementation status reports is fragmented. This is because not all settlements are included in LCOS. For example, the status of obligations and activities pursuant to a settlement reached in 1984 is not routinely reported in LCOS. And, for those settlements that are included in LCOS, the system focusses only on the status of federal government obligations. Where LCOS identifies necessary action, time frames are not generally indicated. Thus, the conditions that led to the required action may be perpetuated.

**14.74** In addition, when completion dates are identified, there is little evidence that progress has been tracked against these dates. As well, we could find no departmental criteria on how the adequacy of implementation would be assessed.

**14.75** The status of obligations belonging to the other parties is reported separately by them or through implementation committees on which the Department is represented. Accordingly, the Department obtains information on the status of the other parties' obligations that can help it to discharge federal government obligations. However, consolidated reporting of all obligations at regular intervals in a standard format is not done on a timely basis. For example, for a 1993 settlement agreement, the only

available consolidated internal status report, as of June 1998, covered the period ended March 1996. And, like LCOS, time frames for completion of necessary actions are not indicated.

**14.76** In addition, a general review of a 1992 implementation plan, for five years ending in 1997, recommended that Canada and the territorial government organize a working group by June 1998 to review, implement and monitor the economic measures provided for in the related 1992 settlement agreement. Further, with respect to a 1975 agreement, the most recent implementation review published by the Department was in 1982.

**14.77** In addition to LCOS monitoring reports, the Department co-ordinates the preparation of annual reports on the reviews of settlement agreements. These reports describe the implementation activities undertaken and this information is provided by the parties to the agreements and others who are involved in implementation. We believe these reports are a useful method of communicating the implementation of claim settlements. However, their usefulness could be enhanced by including information on the results and impacts of claim settlements on the affected communities.

**14.78** With respect to evaluations, none of the four settlement agreements in the audit sample calls for an evaluation of all key implementation impacts, and none has been performed. One agreement, reached in 1984, requires a full and public review in the year 2000 of the efficacy of the provisions for economic measures, a delay of 16 years.

Evaluations should be carried out on a timely, periodic basis.

**14.79** In another agreement, reached in 1993, there is a requirement to review the effectiveness of the provisions relating to economic development by 2010, a delay of 17 years.

**14.80** Evaluating the implementation of settlement agreements could:

- assist the Department in discharging its broader responsibilities of its overall mandate;
- assist other parties in the implementation of the agreements;
- assist Aboriginal and non-Aboriginal communities in adjusting to or benefiting from the impacts of settlements; and
- enhance accountability for the implementation of settlement agreements.

**14.81** We recognize that evaluating the impacts of claim settlements can be very complex and difficult. However, we believe that waiting for a period of 15 years or more to commence such evaluations increases the difficulties. The nature and potential magnitude of the effects of settlements suggest that such evaluations would best be carried out on a timely, periodic basis. This would allow information on results to be built up over time and, among other things, would provide the necessary information to guide future settlements.

### Implementation disputes

**14.82** The nature and scope of settlements suggest that occasional disagreements on implementation can occur. Indeed, settlement agreements usually provide for dispute resolution mechanisms. And, except as may be provided under the terms of the agreements, no party can prevent another from resorting to litigation. Although we do not take a position on any litigation, disputes that go to litigation raise questions about the effectiveness of the settlement agreements and their implementation.

**14.83** Several lawsuits against the Crown came to our attention during the audit. Examples include one filed by a third party and three filed by First Nations. One case involving the first modern settlement is a 1996 claim for $5.4 billion against Canada and other parties. First Nations are seeking relief for

alleged breaches of obligations under the agreement. The allegations relate to:

- Aboriginal and treaty rights;
- social and environmental protection; and
- funding under the agreement for land use, tourism, health, education, training, employment, fishing, housing, capital items and other matters.

**14.84** In another case, filed in 1997, a First Nation is seeking damages in connection with the alleged failure of Canada to establish the Land and Water Board to regulate land and water use throughout the settlement area. The Board was required under the settlement agreement signed in 1992. The lawsuit asks for $2 million and an order requiring Canada to perform its obligations under the agreement.

**14.85** In another case, filed in 1995, a First Nation alleges that the Crown is not allocating a proper share of resource royalties to the First Nation as required under the 1993 agreement. The matter stems from differing interpretations of the intent of the applicable clauses.

**14.86** In a case filed in 1996 by a third party, compensation is being sought for alleged damages relating to the allocation of land under settlement agreements. The issue surrounds the disagreement between Canada and another jurisdiction involved in the land claim settlement over who is responsible for paying compensation that may be provided under the claim settlement. Although the two governments later reached an agreement on responsibility, the third party's claim is still outstanding.

**14.87 Indian and Northern Affairs Canada, together with the other settlement parties, as applicable, should:**

- **ensure that agreed-upon implementation plans contain adequate details regarding time frames, project costs, and cost sharing;**
- **address issues relating to fragmentation, completeness and timeliness of reporting; and**
- **perform periodic evaluations of settlement implementation on a timely basis.**

## Costs to Reach and Implement Settlements

**14.88** Determining and reporting accurate and complete cost information is important to help ensure the cost effectiveness of the claims process, the results produced, and accountability to Parliament. Costs are also needed to determine implementation budgets and sources of financing.

**14.89** The Department does not report the complete costs of reaching and implementing settlement agreements. Although the costs of the financial compensation components of settlements are generally known, other costs associated with settlements have been identified only on a piecemeal basis, or not at all. Other costs include those involved in reaching a settlement, the potential value of transferred land ownership and access rights, consolidated costs of other federal departments involved in the claims process, costs of various projects under implementation plans and responsibilities under the agreements, and costs of resource and revenue sharing. For some things, only estimated costs may be identifiable. However, we believe that where actual costs cannot be determined, this fact should be disclosed so that the extent of accountability for reaching and implementing settlements can be clarified.

**14.90 Indian and Northern Affairs Canada should report the complete costs of reaching and implementing settlements and compare them with relevant budgets.**

## The British Columbia Treaty Commission

**14.91** The B.C. Region is unique in its approach to treaty settlements. The approach in this region is framed by the British Columbia Treaty Commission (BCTC) initiated by the federal government, the government of British Columbia, and the First Nations Summit in 1992.

The full costs of reaching and implementing agreements are not adequately disclosed.

**14.92** In 1993, the BCTC began to receive statements of intent from First Nations wanting to enter the treaty process. The purpose of the BCTC is to facilitate the negotiation of treaties and related agreements. The duties of the Commission include:

- receiving statements of intent and assessing the readiness of the parties to commence a treaty negotiation according to predetermined criteria;
- encouraging timely negotiations and monitoring progress;
- allocating funding to First Nations;
- assisting the parties to obtain dispute resolution services;
- maintaining a public record of negotiations; and
- preparing annual reports for tabling in Parliament, the British Columbia Legislature and the First Nations Summit and for public distribution.

**14.93** The Commission does not make binding orders, determine territorial boundaries, arbitrate disputes or negotiate on behalf of any party.

**14.94** As the federal government's representative in land claims in B.C., the Federal Treaty Negotiation Office of Indian and Northern Affairs Canada will not negotiate modern treaties with a First Nation who has not entered the BCTC process. In these instances, the only recourse available to the band is litigation. As of July 1998, 74 bands of a total of 197 bands in B.C. had not entered the process.

**14.95** The BCTC treaty process involves six stages, as set out in Exhibit 14.7. Indian and Northern Affairs Canada relies on the BCTC for accepting First Nations into the treaty process. As of July 1998, 36 out of 51 negotiations were progressing toward a stage 4 agreement in principle; 15 were at earlier stages of the process.

**14.96** The Commission has identified several aspects of the treaty negotiation process that require attention, including:

- overlapping claims (by more than one First Nation);
- the differences among First Nations in their capacity to settle claims;
- the need for greater third-party consultations and education;
- appropriateness of when to suspend negotiations in the event of litigation;

**Exhibit 14.7**

**British Columbia Treaty Commission Six-Stage Treaty Process**

The treaty process entails:

1) the filing of a statement of intent by a First Nation;
2) preparation for negotiations, including a determination of readiness of the parties;
3) negotiation of a framework agreement;
4) negotiation of an agreement in principle;
5) negotiation to finalize a treaty; and
6) implementation of a treaty.

**Source:** British Columbia Treaty Commission

- the capacity and resources of the governments of B.C. and Canada to enter into multiple, concurrent negotiations; and

- the adequacy of funding to First Nations for negotiations.

**14.97** First Nations that have entered the process may be funded for their negotiations by repayable loans (80 percent) and contributions (20 percent). Canada provides all the loan funding and 60 percent of the contributions. The government of British Columbia provides 40 percent of the contributions. The Commission makes funding decisions subject to available resources.

**14.98** As of early 1998, Canada's cumulative share of funding for treaty negotiations since 1994-95 was $90 million. No settlements have been reached under this process. The BCTC indicated that it does not have the mandate to set deadlines. This raises questions about the time and cost implications for settling the demands of the 123 bands that have expressed interest in reaching treaties.

### Non-Parties to a Claim

**14.99** Settled claims can affect non-parties to the settlement. Examples include small but important businesses such as outfitting, larger enterprises such as mining, and First Nations that are not parties to a specific settlement but that have land or other interests that overlap settlement areas.

**14.100** With respect to certain types of enterprise in some settlement areas, we found indications that little opportunity had been provided for their input to decisions on the allocation of land and other provisions in settlement agreements.

**14.101** In one case, an association representing over 20 tourist businesses alleged, among other things, that the settled land had blocked their normal operating areas, preventing efficient access to big game and thus impeding their business. As well, they believe that settlement negotiations have omitted consideration of non-native historical land use and that the general population has not been adequately represented.

**14.102** Another association reported its concerns about the lack of opportunity for input to the claims process and the lack of information on how land is selected for settlement.

**14.103** We do not take a position on these perspectives and acknowledge that other types of enterprise may have other perspectives.

### Perspectives of Selected First Nations Involved in Comprehensive Land Claims

**14.104** Given the role of First Nations in the resolution of claims, we sought their perspectives on the claims process and results. These are set out in Exhibit 14.8. Again, we do not take a position on these perspectives.

## Conclusion

**14.105** Resolving comprehensive land claims is a difficult challenge for all those involved. The political will, expectations and good faith of all parties in negotiations can directly affect the content of settlement agreements, the time taken to reach and implement settlements, the cost effectiveness of the entire process and the overall results produced.

**14.106** In considering the government's objectives for negotiating claim settlements and how these could be achieved, we concluded that reaching an agreement is a significant milestone. However, it does not by itself constitute a complete achievement. There are some opportunities to resolve some fundamental issues.

**14.107** We believe that the ultimate success of existing and future modern treaties will depend largely on how the parties define and act on their expectations for the removal of uncertainty and for the clarification of the rights of all parties. In addition, the parties' satisfaction with implementation progress and results will be a significant factor that helps determine the long-term benefits of negotiating settlement agreements.

**14.108** Since a significant number of claims have yet to be resolved, Indian and Northern Affairs Canada needs to address the matters and concerns identified in this chapter that fall within its responsibilities.

***Department's response:*** *The Department is committed to resolving by negotiation, rather than litigation, issues of claims to Aboriginal rights and title in Canada. This approach was endorsed in the 1997 Supreme Court of Canada decision in* Delgamuukw, *which summed up the situation with the statement "Let us face it, we are all here to stay." The first modern land claims agreement or treaty, the James Bay and Northern Quebec Agreement, was concluded in 1975. Since then, 12 final land claims agreements, one agreement in principle and 41 framework agreements were completed in areas of Canada not previously covered by treaty.*

*The Auditor General's report reviews treaties negotiated over a period of more than 20 years, largely negotiated in the 1970s and 1980s, and highlights shortcomings of previous policies and practices, which have evolved considerably during this period. For example, as noted by the Auditor General, multi-party implementation plans have been negotiated to accompany all settlement agreements reached since 1986. For claims settled earlier, we had made efforts to negotiate implementation agreements after the fact, with success in most cases.*

*We agree with the Auditor General that there is always room for improvement in implementation monitoring and reporting*

**Exhibit 14.8**

**Perspectives of Selected First Nations Involved in Comprehensive Land Claims**

- The scope of the final agreement does not adequately cover the claim issues. Self-government-related issues remain unresolved and too much of the agreement is open to interpretation.
- The failure of Canada to establish the required Land and Water Boards is a concern.
- The settlement has created employment in their area and capital distribution of settlement compensation has enabled the start-up of businesses.
- The inefficiency of the settlement process has cost the community 31 percent of the value of its settlement compensation.
- Evolving common-law principles, self-government negotiations and the claim settlement agreement are not harmonious, thus increasing uncertainty.
- The wording of the settlement agreement is ambiguous, necessitating the use of dispute resolution provisions.
- The implementation plan is not attainable within a reasonable time frame because the funding provided to First Nations for implementation is insufficient.
- The funding was not based on a costing of responsibilities and activities as described in the plan, but was offered on a "take it or leave it" basis.
- Implementation is not proceeding efficiently and the post-settlement relationship between the parties is not harmonious.
- Self-government issues as perceived through the settlement agreement and implementation plan are not dealt with adequately.
- There are benefits of a parallel self-government agreement but "...the implementation of the final settlement agreement is comparable to paddling upstream against a very strong current..."

**Source:** Office of the Auditor General of Canada

*practices. The Department is continually striving to improve these practices in concert with the other parties and stakeholders. In the early 1990s, the Department initiated a rigorous, multi-faceted regime of implementation monitoring and reporting against implementation plans. A consolidated annual report is prepared on the implementation of each settlement agreement for public distribution and tabling in Parliament. As well, many agreements call for comprehensive five-year reviews, the first of which is now being completed for the 1992 Gwich'in agreement.*

*Government's approach to achieving certainty in respect to lands and resources has also evolved since the 1970s, when the Crown had the power to extinguish Aboriginal title. The* Constitution Act, 1982 *protects existing Aboriginal rights from such unilateral action. New land claims agreements reflect evolution in this area as all parties struggle to find legal text to achieve certainty in regard to lands and resources. The lack of litigation to date over Aboriginal title in areas covered by these modern treaties is cause for optimism that the goal of legal certainty is being achieved. As the Auditor General has pointed out, however, the satisfaction of all of the parties with what has been negotiated, and the successful implementation of treaties, will contribute to the certainty of results far beyond the legal protection that governments and Aboriginal groups seek to obtain.*

*The negotiation process itself has also been greatly streamlined over the years. Since 1986, the negotiation of framework agreements as a first stage has allowed the parties to develop a relationship and clarify expectations by reaching agreement on subject matters, working procedures and target dates. Over two-thirds of those First Nations that have entered the British Columbia Treaty Commission process since its inception in 1993 have concluded framework agreements and embarked on agreement-in-principle negotiations.*

*All agree that further improvement is necessary in the length of time required to negotiate treaties. In partnership with Aboriginal groups, provincial governments and other stakeholders, we are exploring ways to accelerate the process, while respecting roles and relationships so that trust in the process and outcomes is maintained and enhanced. However, since treaty negotiations seek to resolve complex issues of long-term significance, governments as well as claimant groups must take the time required to satisfy themselves that the agreement will adequately address their interests for the future.*

*Another area that is being addressed is the capacity of Aboriginal groups with valid claims to conduct negotiations while at the same time undertaking other increased responsibilities, such as providing advice to governments on proposed development in their traditional territories. This issue is one that has been identified in the review of the British Columbia treaty process, and that the federal government has addressed by the establishment of a special capacity-building fund in that province. This is consistent with the* Gathering Strength *initiative (government's response to the report of the Royal Commission on Aboriginal Peoples), which sets out an approach for renewing the partnerships with Aboriginal people, supporting strong people, communities and economies, strengthening Aboriginal governance and developing a new fiscal relationship.*

*Internal practices have also seen improvements; for example, analyses of potential mineral values of possible settlement lands are now being used to support negotiations. Horizontal linkages between departments have been developed. In the treaty-making process, close collaboration with other departments is routine. In particular, the*

*Department of Justice assigns counsel full time to negotiating teams to provide advice on chapters as they are being negotiated. As well, a full review is conducted throughout government departments prior to conclusion of framework agreements, agreements in principle and final agreements.*

*Costs of reaching and implementing settlements are contained in each department's Main Estimates and annual Performance Reports, as well as in Public Accounts. In addition, annual reports on the implementation of each settlement agreement provide useful summaries of most settlement and implementation expenditures. This department meets all required reporting and disclosure standards and has played a lead role among departments in improving reporting to Parliament, in particular by its horizontal display of Aboriginal expenditures by all departments. However, the publication of financial information on settlements in a manner that is comprehensive and accurate, yet easily understood, is a continual and complex challenge.*

*Canadians support the negotiation of land claims agreements to settle issues of long-standing concern and to allow Aboriginal citizens to participate fully in society by regaining control of their communities through self-government arrangements. Many lessons have been learned, and the process continues to evolve as new models are tried and all parties adapt to changing circumstances. While the stakes are high and the negotiations complex, we will continue to accept the challenge, since we believe that the negotiation of treaties will benefit all Canadians and contribute to Canada's international reputation as a country that can demonstrate peaceful ways of resolving our differences.*



# About the Audit

## Objective

The main objective of the audit was to identify opportunities for improvements in the way claim settlements are being reached, implemented and reported, in the context of the government's objectives for settling claims.

## Scope and Approach

The work was performed in selected regions of Indian and Northern Affairs Canada that continue to be significantly involved in comprehensive land claims. They included parts of British Columbia, the Northwest Territories, and Yukon. The audit also included a review of selected matters in the Department's headquarters in Ottawa. In addition, we inquired into the status of a 1975 claim settlement in Quebec.

We examined, in varying degrees, four settlements that had been finalized between 1984 and 1993 (at the start of the audit, 1993 was the year of the most recent settlement). These agreements provided an opportunity for reviewing all phases of a settlement while they continue to be implemented. The total value of the known, direct compensation of the four settlements is approximately $350 million and the amount of land with full Aboriginal ownership covered by the agreements in the sample totals approximately 160,000 square kilometres in the North. In addition, we reviewed selected matters relating to other settlement agreements.

We also met with the British Columbia Treaty Commission to obtain an overview of its mandate and status of claims in the region and to explore certain issues. As well, we obtained the perspectives of selected First Nations involved in comprehensive land claims as well as some of those affected by them.

## Criteria

We expected that:

- comprehensive land claim settlements would result in the removal of uncertainty, increased socio-economic development in the claimed areas, fairness to all parties and non-parties to the settlement and a reasonable determination and transfer of financial and other resources and rights;
- comprehensive land claim policies and procedures would be applied to every claim as intended by the government and in accordance with principles of cost effectiveness and accountability;
- settlement agreements would be reached in a timely manner and be properly implemented; and
- comprehensive land claim activities and results would be reported appropriately.

## Audit Team

Assistant Auditor General: Don Young
Principal: Grant Wilson
Director: Ted Bonder

Bruce Carroll
Julie Erb
Kathleen Hobbs
Suzanne Moorhead
Marjorie Pound
Anne-Marie Smith

For information, please contact Grant Wilson.

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# Report of the Auditor General of Canada to the House of Commons

## Chapter 15
Promoting Integrity in Revenue Canada

**September 1998**

# Report of the Auditor General of Canada to the House of Commons

**Chapter 15**
Promoting Integrity in Revenue Canada




# September 1998

*This September 1998 Report comprises 9 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.*

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# Chapter 15

## Promoting Integrity in Revenue Canada

*The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.*

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# Promoting Integrity in Revenue Canada

## Main Points

**15.1** The success of Revenue Canada's programs depends largely upon voluntary compliance with tax requirements by individuals and businesses. We believe that one of the many factors affecting the likelihood of their voluntary compliance is their perception of the conduct of Revenue Canada's staff. An organization like Revenue Canada, with its decentralized operations and the extensive exercise of judgment by employees, must take adequate precautions to minimize the risk of employee misconduct. Our audit looked at various means that the Department employs to promote integrity among its employees.

**15.2** All of these means, taken together, form an important foundation for the promotion of integrity in Revenue Canada. The Department investigates incidents of misconduct; discipline is imposed on employees found guilty of misconduct; and, on the whole, management takes appropriate action, where weaknesses are highlighted by incidents, to prevent similar misconduct. Further, distributing statements of its mission, vision and values and three key booklets on conduct are important steps Revenue Canada has taken toward promoting an ethical culture. Most employees have received some formal training on expected conduct.

**15.3** There are areas where improvement will help Revenue Canada reinforce this sound foundation. Because the disciplinary process can be slow, its effectiveness as a deterrent to similar misconduct may be diminished. While management takes action to correct weaknesses highlighted by incidents, at times its responses are slow and focussed narrowly on local rather than department-wide weaknesses. Further, information provided on values and conduct is not presented in a way that allows easy understanding, and training is uneven. The Department takes few steps to monitor the level of employees' understanding of expected values and conduct. Nor does it provide an individual whom employees can consult on a confidential basis on issues of integrity.

## Introduction

**15.4** The success of Revenue Canada's tax, transfer payment, customs and trade administration functions depends primarily upon voluntary compliance with the applicable laws by individuals and businesses. For example, individuals are expected to report their income accurately and to pay the tax required by law; travellers entering Canada are expected to declare the nature and value of certain items that they bring into the country and to pay any duty required by law. Revenue Canada operates various facilitation programs to encourage compliance, and enforcement programs to detect those who are not compliant. For the most part, however, it depends not on these programs but on its expectation that the vast majority of people will comply with their obligations voluntarily.

**15.5** We believe that one factor affecting the likelihood of voluntary compliance is the way individuals and businesses perceive the integrity of Revenue Canada's staff. Organizational integrity is thus an asset whose value lies, in part, in its influence on the behaviour of stakeholders with whom Revenue Canada does business. Like physical and financial assets, organizational integrity is something that demands investment, safeguarding and maintenance. This audit looked at how effectively Revenue Canada manages the asset we are calling "organizational integrity."

### Focus of the audit

**15.6** There is no single, consistent definition of control for organizations. In the narrowest sense, it means ensuring that specific procedures are followed. In the broadest sense, it means creating the conditions that lead to the achievement of the organization's objectives. This suggests that Revenue Canada, in controlling to minimize the occurrence of incidents of employee misconduct, brings a variety of elements to bear on the problem. In past audits of Revenue Canada, we have examined aspects of the Department's internal control systems. We have made recommendations on its internal controls, where we considered it necessary, and followed up to review the implementation of the recommendations. In this audit, we looked at elements that fall into two categories: elements of the Department's "culture," which includes what is sometimes referred to as "informal control"; and elements that represent the learning that takes place as a result of incidents having occurred.

**15.7** In designing internal control systems, organizations typically focus a lot of attention on removing opportunities for employee misconduct. In our emphasis on organizational culture, we focussed on what keeps employees from behaving improperly even when opportunities for misconduct remain. Internal controls cannot function without formal and informal ethical support mechanisms; a strong ethical culture provides a guidepost for employee action. Our emphasis on learning from incidents of misconduct focussed on an important process by which organizations ensure that their policies, procedures and systems are responsive to newly discovered threats in their environments.

Organizational integrity is something that demands investment, safeguarding and maintenance.

**15.8** This is our second report on our work on the topic of ethics in the public service. The first one, a study reported in May 1995, dealt with ethics and fraud awareness in government. The study proposed an ethical framework for government. Elements of that framework, such as a statement of principles, leadership and training, were also addressed in this audit. The topic of ethics in a government environment is an important theme that will continue to command our attention.

**15.9** In performing this audit, we concentrated on three of the Department's business lines at the operational level — collections, audit, and customs — as well as on certain headquarters functions.

Further details on the audit objective, scope and criteria are presented at the end of the chapter in the section **About the Audit.**

## Observations and Recommendations

### The Environment in Revenue Canada

**Like any organization, Revenue Canada is vulnerable to employee misconduct**

**15.10** It will come as no revelation that Revenue Canada is vulnerable to employee misconduct. In the past several years, a number of incidents have been reported publicly (see Exhibit 15.1):

- A collections officer became overzealous in his pursuit of a debt owed to Revenue Canada, inflicting financial and psychological distress upon the debtor.
- A manager accepted a bribe from a taxpayer suspected of tax evasion, in exchange for dropping the investigation.
- A collections officer devised a scheme for claiming fraudulent refunds of Goods and Services Tax.
- A manager colluded with a number of employees to make fraudulent claims for overtime pay and received kickbacks from the employees.
- A customs officer was charged as an "inside man" in a scheme involving the diversion to domestic use of liquor bound

Exhibit 15.1

Media Coverage

*Le Journal de Montréal* — *le 23 décembre 1997*

**Un fonctionnaire du fisc demandait des commissions**

Jugé coupable de trois fraudes contre le gouvernement fédéral, l'homme de 45 ans, de Saint-Bruno, connaîtra sa peine

Afin d'examiner toutes les demandes de déduction fiscale de cette catégorie, Revenue Canada a dans les grandes villes

*The Financial Post* — *August 16, 1989*

**Mistreated taxpayer gets punitive damages**

Sometimes there's good news out of Ottawa for those who feel they have been mistreated by federal

In a recent court decision the federal government was ordered to pay $11,000, including $10,000

ages, to a taxpayer who was treated "maliciously" by Revenue Canada's collection officials in Halifax.

*The Ottawa Citizen* — *June*

**GST employee charged with fraud**

*LeDroit* — *jeudi 20 mars, 1997*

**Un ex-directeur de Revenu Canada coupable d'abus de confiance**

L'ex-directeur du bureau des enquê- accusation d'abus de confiance, soit

*Le Droit* — *le 16 août,*

**Fraudeur en les murs**

Un employé de *Revenu Canada Impôt* fait face à des accusations de fraude

La Gendarmerie royale du Canada a arrêté, hier, l'ancien directeur adjoint des Services aux employeurs du Centre fiscal d'Ottawa, chemin Heron, à la suite d'une

enquête de trois mois sur des alle de fraude mettant en cause des fau mandes de rémunérations d'heur plémentaires présentées par des er de Revenu Canada Impôt à Ottaw.

*Calgary Herald* — *January 30, 1996*

**Customs official, Calgary businessman among 10 charged in liquor scam**

A Canada Customs inspector and a Calgary businessman are among 10 people and two businesses charged in relation to an elaborate scheme involving unlawful liquor sales.

Investigators allege that 16 truck loads of liquor were fraudulently removed from a High River distillery in 1994, with an estimated retail value of more than $6.5 million.

for export (and, therefore, excise-tax-free).

- A manager tried to convince several contractors to make fraudulent claims for the work they were undertaking for the Department and to pay the manager kickbacks.

**15.11** We reviewed the documentation relating to all 285 incidents of potential employee misconduct reported to Revenue Canada's Security Directorate during the period 1 January 1995 to 30 June 1996. The results of our review provide an indication of the kinds of vulnerability to employee misconduct that are present in Revenue Canada.

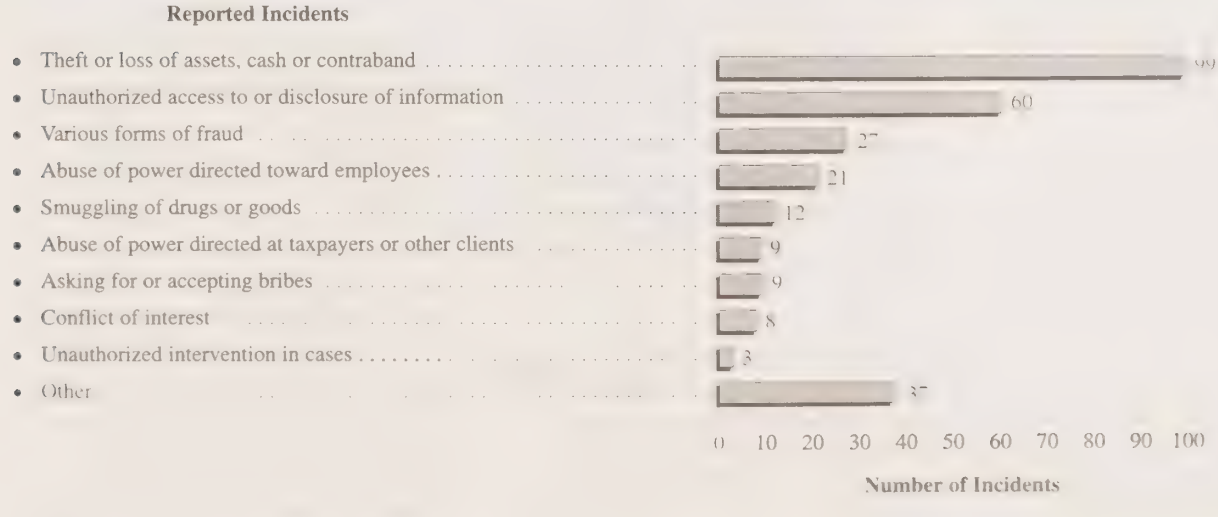
**15.12** The most frequent kinds of reported incidents are described in Exhibit 15.2. Many of these incidents can be clearly associated with employees; other incidents cannot. A prime example of an incident that may not be possible to link specifically to employees is theft, since the Department does not necessarily know the perpetrator's identity. When we completed our review of reported incidents, 69 of the 285 incidents had been referred outside the Department. Of the remainder, in 96 cases the occurrence of misconduct was confirmed and the offending employee was identified; in 115 cases either the occurrence of misconduct or the identity of the employee was not confirmed; and in 5 cases the investigation was still ongoing.

**15.13** It is difficult to draw any conclusions about the rate at which incidents occur. Bearing in mind that Revenue Canada has approximately 40,000 employees, 285 incidents in 18 months may not seem like a particularly high number. At the same time, academic studies of other segments of society strongly suggest that the number of incidents of misconduct that are reported is much lower than the number of incidents that actually occur.

**15.14** We believe that the nature of Revenue Canada's operations makes it more vulnerable than many other departments and agencies to certain forms of employee misconduct. Like other departments that employ peace officers, Revenue Canada faces vulnerabilities

Exhibit 15.2

Types of Reported Incidents




Source: Revenue Canada

The nature of Revenue Canada's operations makes it more vulnerable than many other departments.

associated with its customs operations. In addition, Revenue Canada is unrivalled among government departments in the scale of its collections and its audit operations — operations that also involve significant vulnerabilities.

**15.15** The head of the federal government's Task Force on Public Service Values and Ethics identified two conditions that are sources of ethical challenge for individual public servants: the exercise of judgment and discretion in decisions; and decentralization and delegation of authority. Both of these conditions are present in Revenue Canada. Whether it is a collections officer negotiating a payment schedule with a debtor, an auditor assessing a taxpayer, or a customs inspector conducting a search of an inbound traveller, each has to use judgment and discretion.

**15.16** We supplemented our analysis of reported incidents with information on employees' perceptions of the kinds of vulnerability the Department faces and the precautions it takes to deal with this vulnerability. This information was drawn from face-to-face interviews with 174 employees who were selected as a purposive sample from different hierarchical levels, operational functions, and geographic regions within Revenue Canada. The kinds of vulnerability that employees noted were very similar to those found in our analysis of reported incidents. Sixty-two percent of the employees we interviewed felt that the precautions the Department takes to deal with the identified vulnerabilities are excellent, or very good. Another 28 percent felt the precautions were adequate.

Incidents of misconduct can and do happen.

**15.17** Risk management is an integral part of good management practice. It involves identifying, assessing and addressing risks or vulnerabilities to which an organization is exposed. Although Revenue Canada's managers apply elements of risk management, the Department acknowledges that the process needs to be more formalized. It now has a draft risk management policy that addresses all sources of risk, both internal and external to the Department, including ethical risks. To convey its requirement for formalized risk management, the Department has conducted a number of workshops and is pilot-testing a training course.

## Incidents of Misconduct

**15.18** We have discussed some of the ways Revenue Canada is vulnerable to employee misconduct. While the Department has internal control systems to guard against the occurrence of abuse, it is not realistic to expect that incidents of misconduct can be entirely eliminated in an organization of Revenue Canada's size and with its lines of business. Incidents of misconduct can and do happen in any region and at any hierarchical level within Revenue Canada. This means that all parts of the Department must have the means to deal with incidents, which entails first becoming aware that they have happened. Only then can the Department investigate the incident, discipline the offender, and take steps to prevent similar incidents. Exhibit 15.3 provides an overview of the processes for handling incidents, from reporting to final discipline.

### Incidents of misconduct are reported

**15.19** We found that a wide range of people have detected and reported incidents. While almost a third of the incidents we reviewed had been reported by people outside the Department, managers and other departmental employees had reported the other two thirds. Two factors encourage people to report incidents of misconduct: first, they have information on what and to whom to report; and second, their working environment is supportive of such reporting.

**15.20** The Revenue Canada employees we interviewed knew that they should

report incidents of misconduct. When we asked what steps they are expected to take upon learning of an incident, almost 75 percent of them stated that they should notify management or a supervisor. The next most frequent response (17 percent) was that employees should report the incident to security. These are, indeed, the courses of action recommended by the Department's security booklet.

**15.21** The extent to which an organization supports the reporting of rule violations is an important indicator of both its commitment to its own rules and its credibility in the eyes of its own employees. Seventy percent of the departmental employees we interviewed felt that their work environment was very supportive of the reporting of infractions, and another 20 percent stated that it was somewhat supportive.

### The Department investigates misconduct

**15.22** Once an incident of potential misconduct has been reported, the

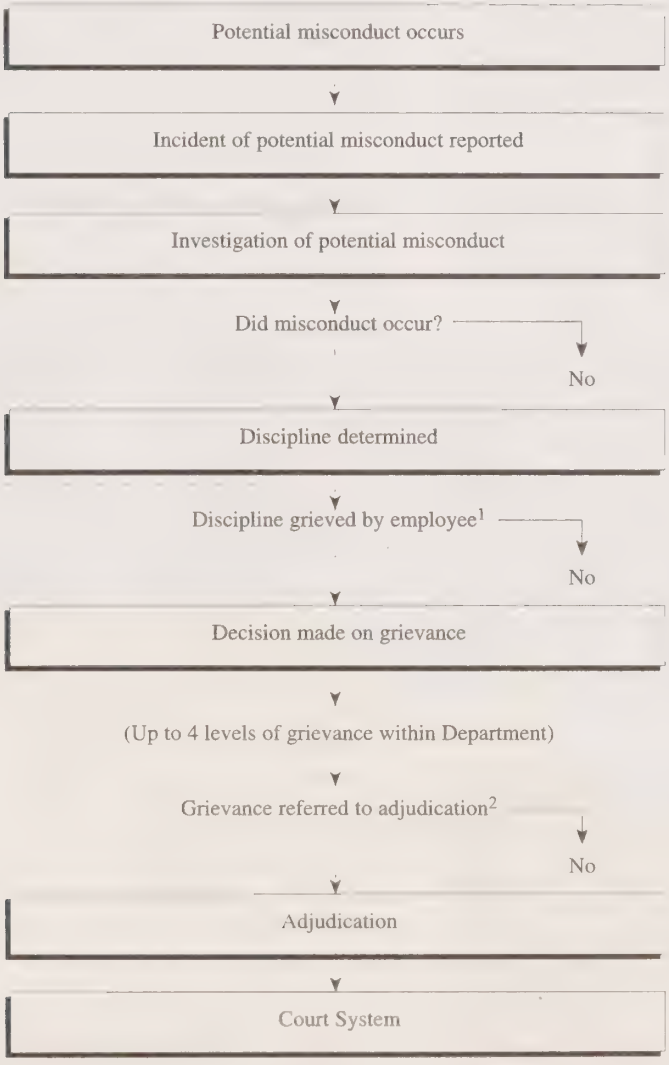



Exhibit 15.3

**Processes for Handling Incidents from Reporting to Final Discipline**

[1]Dismissals grieved go to the fourth level within the Department

[2]Only grievances involving suspension, dismissal or financial penalty may be referred to adjudication

The Department investigates to determine whether misconduct has actually occurred and whether offenders can be identified with certainty.

Department investigates to determine whether misconduct has actually occurred and whether the offenders can be identified with certainty (Exhibit 15.4). Revenue Canada's central investigative body is its Security Directorate at head office. Through discussion, the Directorate and local management determine who should investigate a given incident. Depending on the nature of the incident and the expertise required, this could be the Security Directorate, local management or the appropriate police authority. The Directorate had conducted the investigation in almost 60 percent of the incidents we reviewed. Thefts of money must be reported to the local police and bribery cases turned over to the RCMP; harassment cases may be handled by local management.

**15.23** Incidents are supposed to be reported immediately by local management to the Security Directorate. The Directorate requires up-to-date information to enable it to brief departmental senior management each week on all security incidents. Despite a requirement that incidents are to be reported immediately, in 68 percent of the cases we reviewed, the Security Directorate had not been notified of the incident within three days of its occurrence. As might be expected, the seriousness of the incident seemed to be a factor in determining how quickly incidents were reported: the Directorate was immediately notified more often about the most serious incidents.

**15.24** In fact, it was primarily the most serious infractions that were brought to the attention of the Security Directorate. There is a tendency to resolve many infractions at a local level or informally, rather than to report them at the outset to the Security Directorate. This is the tendency in other organizations as well. Most organizations tend to experience many more minor rule violations than major ones.

**15.25** Regardless of who undertook the investigation in Revenue Canada, we found that they started their investigation of incidents relatively quickly. Close to two thirds of the investigations we reviewed began within seven days of the incident's discovery; one third of investigations were started within one day. The duration of the investigations by Revenue Canada ranged from one day (mostly for thefts turned over to the local police) to about 9 months. Most are completed within 60 days.

### Misconduct results in discipline and other corrective action

**15.26** On completion of an investigation, the investigator reports to the manager of the location in which the incident occurred, who then determines what disciplinary action, if any, is appropriate. Discipline may serve either or both of two purposes. For the most part, it is meant to deter both the offender and other employees from like misconduct in the future. However, in rare circumstances it is meant to impose a penalty on the offender for specific misconduct. Its success can be judged only by how well it achieves both purposes.

**15.27** In Revenue Canada, an offender's delegated manager in consultation with a staff relations advisor and, if appropriate, other departmental officials determine the disciplinary action for a specific incident.

Exhibit 15.4

**Example of an Alert Revenue Canada Employee**

**Alert to misconduct of an employee in another office**

In one case, an alert officer handling the Department's inquiry line reported a suspicious comment made by a caller. The caller, who had a tax preparation business, had contacted Revenue Canada with a routine inquiry. The individual stated that he knew there were errors in tax returns he had submitted and that he wanted an explanation. The caller said he had learned of the errors from a Revenue Canada employee with whom he was acquainted. The officer suspected that the caller's acquaintance had acted inappropriately in giving out the information and referred the matter for investigation. The investigation revealed that the Revenue Canada employee had indeed violated departmental regulations by accessing taxpayer information and disclosing it to an acquaintance.

**Source:** Revenue Canada

Departmental guidance reveals the general principle that the more serious the misconduct, the more severe the discipline (see Exhibit 15.5). We found that the severity of discipline tended to increase with the gravity of the incident. However, it was a weak pattern. In part this is because the Department takes into account a number of factors in determining what discipline is appropriate, such as the nature and seriousness of the misconduct itself and the past history of the individual involved.

**15.28** Employees have the right to grieve disciplinary actions applied against them. The grievance process has four potential steps within the Department. Should employees still be dissatisfied with a disciplinary decision involving suspension, dismissal or financial penalty, they may go outside the Department for an adjudication hearing.

**15.29** Grievances were heard in 40 percent of the cases we reviewed in which disciplinary action had been imposed. Over 85 percent of grievances went to the final level in the Department or to adjudication.

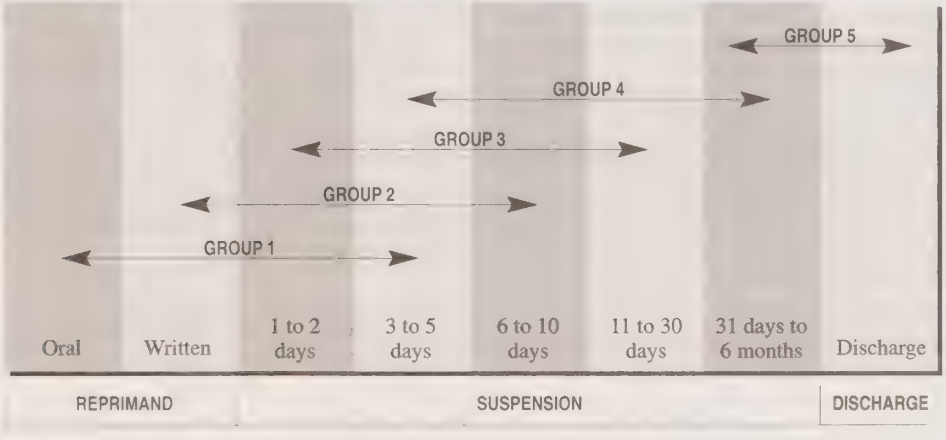
**15.30** It is interesting that of the cases we reviewed, those involving the most serious infractions tended to move along more quickly in the reporting and investigation stages than did those involving lower-level offences, but tended to slow down considerably in the disciplinary and grievance stages. There appears to be a relationship between the seriousness of the offence and the time it takes to impose a final disciplinary action. In part this is because more serious cases are more likely than less serious cases to be grieved.

**15.31** Discipline is not the final action that the Department needs to take as a result of misconduct. It needs to correct

Exhibit 15.5

**Disciplinary Action**

*This chart indicates the range of possible disciplinary actions.*




**Examples of items in the five groups**

GROUP 1 – Failure to notify Department when late
– Use of abusive language

GROUP 2 – Leaving while on duty without permission
– Failure to report a work-related accident

GROUP 3 – Violation of the conflict-of-interest policy
– Interfering with or impeding the work of others

GROUP 4 – Unauthorized access to files
– Assault

GROUP 5 – Theft
– Disclosure of confidential information

**Source:** Revenue Canada

Revenue Canada needs to correct any weaknesses highlighted by an incident in order to prevent similar incidents.

any weaknesses highlighted by an incident in order to prevent similar incidents. These could be weaknesses in systems and procedural controls or in information and training provided to staff.

**15.32** We studied incidents of misconduct in which there were indications of weaknesses requiring attention, to determine what action management had taken. In most cases we reviewed, management had acted to correct observed weaknesses. On the whole, its responses were appropriate.

**15.33** The preceding paragraphs demonstrate that Revenue Canada reacts in a determined and responsible manner to serious incidents of misconduct. We are not aware of any serious incidents for which the Department failed to arrange for an investigation, to impose disciplinary action, or to initiate action to correct any control deficiencies that had contributed to an incident's occurrence. While we did note certain areas for improvement (see paragraphs 15.54 to 15.87), we do not wish to undervalue the sound practices that are currently in place.

**15.34** We wanted to discuss early in this chapter the Department's experience with incidents of misconduct for two reasons. First, by doing so we illustrate the nature and range of incidents to which Revenue Canada is vulnerable. Second, we feel that this discussion reveals much about Revenue Canada's attitude toward employee misconduct. Having set the stage, the chapter will now look at some of the things the Department does to promote the prevention and detection of employee misconduct.

## Promoting an Ethical Culture

**15.35** We have noted that Revenue Canada is vulnerable to employee misconduct and that incidents do occur despite internal control systems. Internal controls are only one element in the overall control regime. The other element involves motivating people to act with integrity even when opportunities exist for misconduct. A strong ethical culture within an organization provides such motivation for employees.

**15.36** The modern trend in organizations is to make deliberate choices about the kind of culture they want to nurture, and to use vision, mission and values statements, in part, to convey information about that culture. We looked at Revenue Canada's revised vision, mission and values statements to see if they appeared to promote an ethical culture, and we found that they did. The opening sentence of the Department's vision statement reads: "Revenue Canada will be recognized and respected by clients for its integrity, fairness, and innovation in administering high-quality, yet affordable programs." Further, Revenue Canada's stated values include integrity, professionalism, respect and co-operation (Exhibit 15.6).

**15.37** The Department's mission, vision and values statements compare favourably with similar statements put out by private sector organizations. Together, they form a strong foundation for ethical conduct. Some improvements are still possible. For example, the vision statement could give greater recognition to the interests of employees, as it has to the interests of clients and government.

**15.38** These important statements were in departmental planning documents, the latest version of which was distributed to employees during the summer of 1997. Managers received the strategic plan containing the full mission, vision and values statements, while other employees received a pamphlet with the mission, values and a condensed vision statement.

### Leadership is key in promoting an ethical culture

**15.39** Publishing and distributing statements of vision, mission and values are important, but are only a part of what is needed to instil an ethical culture in an organization. Employees look to senior

management to determine whether these statements are really expected to guide conduct or whether they are just empty rhetoric. A stated and visible commitment by senior management is essential to establish and maintain an ethical culture. Openness is one sign of management's commitment.

**15.40** Lower-level managers whom we interviewed in offices across the country often noted that their senior managers operate with openness. However, a recent joint union-management survey of auditors suggests that managers and employees do not share a common view of the degree of openness displayed in the Department. In their answers to the survey questionnaire, fewer than 25 percent of the auditors described the current culture of Revenue Canada as open.

**15.41** The involvement of employees at all levels in the Department — those on the front line as well as those in the boardroom — is needed to create an ethical culture. Revenue Canada's senior management encourages managers to discuss issues with their employees. For example, senior management asked local managers to make use of National Public Service Week and the distribution of the harassment policy to discuss issues with the staff. In addition, there were local activities. We heard about "town hall" meetings to distribute information to employees and to discuss departmental initiatives. One office had formed an employee-management team to promote a professional workplace environment.

**The involvement of employees at all levels in an organization is needed to create an ethical culture.**

### Information provided to staff

**15.42** In addition to the mission, vision and values statements, Revenue Canada revised three key booklets that convey to employees its expectations for their conduct. The revised booklets on standards of conduct, conflict of interest and security were distributed to employees in 1995. All employees need their own copies to facilitate their understanding, provide ease of reference, and enhance acceptance of the documents' provisions. The great majority of the employees we interviewed had received copies of the documents.

**15.43** Finding other opportunities to repeat the messages contained in written codes of conduct reinforces management's efforts to promote an ethical culture. Over three quarters of the employees we interviewed reported that they receive information on employee conduct from departmental sources such as memos, directives, and team meetings. Managers

Our values include integrity, professionalism, respect, and co-operation.

***Integrity***
is the cornerstone of our administration and it means treating people fairly and applying the law fairly. Integrity requires that we act with honesty and openness.

***Professionalism***
is the key to success in achieving our mission and it means being committed to the highest standards of achievement. Professionalism requires that we act with dedication and skill.

***Respect***
is the basis for our dealings with colleagues and clients and it means being sensitive and responsive to the rights of individuals. Respect requires that we act with courtesy and consideration at all times.

***Co-operation***
is the foundation for meeting the challenges of the future and it means building partnerships and working together toward common goals. Co-operation requires that we act with leadership and innovation.

Exhibit 15.6

Revenue Canada's Values

**Source:** Revenue Canada

and supervisors were more likely than front-line staff to receive such information.

### Ethics training

**15.44** Employees need to know what is expected of them and what the consequences will be if the rules are not followed. Providing them with written information and expecting that they will read and understand it is not a sufficient strategy on its own. Employees receive so much information that they may not have time to read and understand it during the course of their normal working day. Training that takes place away from the regular work setting and allows employees time to concentrate on the information being conveyed is a vital supplementary strategy. Aside from conveying needed information, providing formal training courses conveys a sense of the importance and seriousness that management attaches to the issues being covered.

**15.45** Over 85 percent of the employees we interviewed said they had received some formal training at some point in their career on the subject of expected behaviour.

The arrival of new employees provides the Department with an opportunity to convey its values and standards of conduct through training.

**15.46** The arrival of new employees also provides the Department with an opportunity to convey its values and standards of conduct through training. Although there is no department-wide orientation course for new employees, two of the three business lines we reviewed have their own courses. Orientation training is part of both the in-residence training program for new customs inspectors and the technical training program delivered locally to new auditors.

**15.47** After the orientation period has passed, training focusses on what employees need to know to do their jobs. Technical training for employees emphasizes how to apply legislation and use standard operating procedures, but it also covers some aspects of standards of conduct and values. Common subjects that are addressed in technical courses are the rules regarding confidentiality of client information and standards of professionalism to be applied in dealing with clients. Managers who participate in formal training also have an opportunity to reinforce commitment to the departmental values by relating their past experiences.

**15.48** An important part of a manager's job is making decisions, and the training that managers receive reflects this reality. Values-oriented training is being emphasized with the aim that managers will apply the Department's values implicitly in their decision making. To this end, Revenue Canada's strategic plan is reviewed in the first-line managers' course and forms the basis for discussion during the middle-management orientation program.

**15.49** About 65 percent of employees we interviewed rated the ethics-related training that they had received as excellent or very good. Another 27 percent rated the training as adequate. For them, it is important that courses be clear and relevant to their tasks, provide concrete examples that define misconduct, and spell out the consequences for potential offenders.

**15.50** Formal training is not the only way that Revenue Canada's management nurtures its ethical culture and conveys the standards of conduct it expects. Through communication and example, Revenue Canada's senior managers encourage other employees to act with integrity. Managers who serve as role models for proper conduct during on-the-job training demonstrate the Department's ethical culture in action. Exposure to such examples is an integral part of absorbing a new employee into the work environment.

### Staffing practices

**15.51** One might expect that it would be easier to maintain an ethical environment if an organization hired only employees having the highest moral

character. Precautions can be taken, but guarantees are not possible.

**15.52** Compared with other government departments, Revenue Canada hires a great many new employees. It has an opportunity in the hiring process to assess the character of potential employees. The opportunity occurs in the process of interviewing and performing checks on candidates selected as potential employees. The extent of these reliability checks depends on the security classification of the job. For the majority of Revenue Canada's positions, the checks include looking for any past criminal record.

**15.53** In its letters of offer, Revenue Canada includes a paragraph outlining the requirement for new employees to certify their understanding of and adherence to the conflict-of-interest code described in the booklet attached to the letter. However, neither the standards of conduct nor the security booklets are mentioned in the letter of offer. Whereas adherence to the conflict-of-interest requirements is a continuing condition of employment, the broader concept of meeting acceptable standards of conduct is not.

## Areas for Improvement

**15.54** We have described various elements of the framework that Revenue Canada employs to promote integrity among its employees. The investigation of potential incidents of misconduct, the imposition of discipline, and the correction of control deficiencies are three key elements. Other elements include the publication of mission, vision and values statements and the three key booklets on conduct that seek to describe the kind of organizational culture that Revenue Canada wishes to nurture. These publications are supported by training that reinforces some of the main messages and by an environment that is regarded by 70 percent of the employees we interviewed as conducive to the reporting of observed instances of potential misconduct.

**15.55** All of these elements, taken together, form an important foundation for the promotion of integrity in Revenue Canada. Still, we find that promoting ethical behaviour is a preoccupation of a great many organizations and that there is a wide body of knowledge that could be drawn upon to further strengthen Revenue Canada's foundation. Because of the vulnerabilities it faces, as revealed by the incidents of misconduct that it has experienced, Revenue Canada needs to always remain open and receptive to ideas that will help it to reinforce the framework that is now in place. This section describes certain areas for improvement that came to our attention.

All of the framework elements, taken together, form an important foundation for the promotion of integrity in Revenue Canada.

### There are some impediments to reporting incidents of misconduct

**15.56** Two possible reasons come readily to mind that explain why people may not report incidents of misconduct to appropriate authorities: first, they may lack information on what and to whom to report; and second, their working environment may not be supportive of such reporting.

**15.57** **What to report to whom.** While employees we interviewed know that they should report misconduct to their managers, managers we spoke to generally are not clear on what type of incidents to report to the Security Directorate. While some managers felt that all cases had to be reported, others indicated that it would depend on the nature and seriousness of the incident. According to departmental policy, managers are to report incidents of employee misconduct to the Directorate. However, managers often considered employee misconduct to be a staff relations issue that ought to be handled by them and not by security. In view of this confusion, the Department currently is clarifying its policy on the reporting of

employee misconduct to the Security Directorate.

**15.58** The booklets on standards of conduct, conflict of interest and security lack information on whom employees can contact for advice on how to apply the policies the booklets describe. Without any other information, presumably employees would contact their supervisors. While this would be an acceptable course of action in most cases, employees may hesitate to ask questions that concern their supervisors' judgment. At such times it would be beneficial to have an individual who could be consulted on a confidential basis. Some organizations have created the position of "ethics advisor" to handle, among other things, inquiries of this type. An ethics advisor can also act as an intermediary between an employee who wishes to report an incident anonymously and the organizational unit that investigates incidents. Providing such protection to employees helps to remove impediments to reporting, because it assures employees that there will be no negative repercussions on them as a consequence of reporting an incident. Six of the 54 employees we interviewed who had suggestions to improve the reporting of incidents said they would want assurance that reporting would carry no repercussions (Exhibit 15.7).

A number of factors can contribute to employees' reluctance to report incidents of misconduct.

Exhibit 15.7

**Measures Suggested by Employees to Improve Reporting of Incidents of Misconduct**

- Improve training on what is unacceptable conduct.
- Actively encourage reporting of misconduct.
- Clarify the reporting process.
- Identify "neutral" persons, instead of supervisors, to whom employees can report anonymously.
- Assure employees that there will be no repercussions for reporting infractions.
- Undertake investigations of alleged misconduct discreetly.
- Disclose more information on decisions taken in previous cases of misconduct.

**Source:** Revenue Canada

**15.59 An environment that supports reporting.** Ninety-one percent of the managers we interviewed regarded the work environment as very supportive of the reporting of infractions; however, only 59 percent of front-line staff we interviewed shared this view of the work environment. It is somewhat troubling that the front-line staff we interviewed perceived their environment as less supportive of incident reporting, because it is front-line staff who may be in a better position to observe misconduct as it occurs. We noted two situations in which misconduct had continued unchecked for over 11 months before someone eventually reported it to management.

**15.60** A number of factors can contribute to employees' reluctance to report incidents of misconduct. One factor is the inherent desire to trust their colleagues. Employees can be very reluctant to make allegations about a co-worker unless they are reasonably confident that the allegations are well founded. This reluctance could be greater if their supervisors or co-workers are also aware of the misconduct but have not reported it. While it is not desirable to have a system that disciplines someone on the basis of an unfounded allegation, neither is it desirable to have a system that fails to hold to account those who commit improper acts. What is needed is a system that encourages the reporting of suspected misconduct, and follows up on reports with an investigation that respects the rights of the alleged perpetrators.

**15.61** Another factor that could deter reporting is the perception that management will fail to act on reported misconduct. Employees interviewed in a recent internal audit expressed concern about the negative impact on morale when appropriate action is not taken to correct unacceptable behaviour of colleagues, including supervisors. One way to assure front-line staff that senior management does act on reported misconduct is to tell them what action has been taken. The

Department could periodically distribute a report that summarizes the disciplinary measures it has taken.

**15.62 Revenue Canada should study the merits of creating the position of ethics advisor, whom all departmental employees could consult on questions of values and conduct.**

***Department's response:*** *In the context of the move to Agency status, Revenue Canada will consider the merits of creating a position of ethics advisor.*

**Application of discipline**

**15.63** To apply discipline fairly and consistently, managers need to know the Department's discipline policy and to have information on the discipline imposed for past incidents. The departmental guidelines on discipline date from before the administrative consolidation of Revenue Canada and are currently being revised. Revenue Canada does not have a data base on disciplinary actions it has imposed. While staff relations advisors have access to a data base of government-wide cases that were decided by adjudication, not all types of incidents necessarily go to adjudication. We were told that local staff relations advisors do not normally discuss incidents or discipline with colleagues in other Revenue Canada offices except those in the head office Human Resources Branch. Managers must rely for their information on the experience and memory of their staff relations advisors.

**15.64** Dealing with individual cases is only part of the process of managing the Department's discipline and grievance programs. For the Human Resources Branch, another part is managing the programs at a strategic level. Variation exists in the disciplinary action for similar misconduct in the Department. Without a data base on disciplinary action, the Department cannot analyze trends in discipline decisions. With no trend analysis and little sharing of information, the Department is hindered in its efforts to ensure fair and consistent application of discipline. A recent internal audit recommended that staff relations advisors and managers be made aware of the disciplinary action being imposed in other offices. As a result, Revenue Canada is planning to capture information on all disciplinary actions, to analyze it and to report to senior management. For its analysis, the Department would need to capture the mitigating factors to understand why this variation in discipline exists for apparently similar misconduct.

**15.65** As shown in Exhibit 15.8, we found that in 23 of 42 cases we reviewed with no grievances, final disciplinary action was imposed within 30 days of the completion of the investigation of an incident of misconduct. In a further 16 cases, final disciplinary action was imposed within 31 days to 6 months, leaving 3 cases in which it took from 6 months to 2 years for final discipline to be imposed. Researchers in the criminal justice field have learned that harsh penalties have a limited deterrent effect due to the lower probability that they will be imposed. In contrast, even relatively mild penalties imposed promptly and with certainty have a greater deterrent effect.

Departmental guidelines on discipline date from before the administrative consolidation of Revenue Canada.

**15.66** It is essential that the salutary effects of discipline be achieved while still protecting the rights to due process of employees found guilty of misconduct. It is for this reason that the grievance process exists. Where a grievance is involved, the average time to determination of final discipline is much longer, although a penalty will most likely have been served on the basis of the initial imposition of discipline. We reviewed 31 cases in which the initial discipline was grieved. Disciplinary action is often reduced following a grievance. For example, two times as many suspensions of more than 10 days were initially called for as were finally imposed.

**15.67 Revenue Canada should study the discipline process to determine**

**whether it is possible to increase the proportion of cases in which final discipline (or where a grievance occurs, initial discipline) is imposed within 30 days of the completion of the investigation of an incident of misconduct.**

***Department's response:*** *Revenue Canada will study opportunities to maximize the proportion of cases where disciplinary action is taken within 30 days of the completion of an investigation into misconduct.*

**Corrective action is slow and narrowly focussed**

**15.68** We studied incidents of misconduct in which there were indications of weaknesses requiring attention, to determine what action management had taken in addition to any disciplinary action. While management's responses to rectify observed weaknesses were for the most part appropriate, at times the responses were very slow. For example, in the 1994 case of a major refund fraud by an employee, Revenue Canada has taken some action in the most critical areas of identified weakness but the work is not yet complete.

**15.69** In the population of incidents we examined, a factor frequently contributing to the occurrence of incidents was a lack of prevention on the part of Revenue Canada — poor security, failure to follow standard procedures, and poor training. Lack of prevention had also been apparent in previous similar incidents, but additional measures had not been taken to reduce the possibility of recurrence. In one case, the premises of other tenants of a building housing Revenue Canada offices had been broken into three times during a three-month period. No preventative action was taken until a break-in occurred at the Revenue Canada office itself.

**15.70** Except for major incidents, there is no concerted effort by the Department to learn from incidents of misconduct that have national implications. Corrective action taken in one office is not conveyed to other offices to prevent similar incidents, even when the affected local office thinks there may be national implications. Providing information to other offices may alert managers there to potential weaknesses in their systems. Recently, the Security Directorate took a step that should help the Department deal with weaknesses highlighted by incidents.

Exhibit 15.8

Time Elapsed Between Completion of an Investigation and Imposition of Final Discipline

*(Number of cases)*

| | Final Discipline – Cases Without Grievance | Final Discipline – Cases With Grievance | Cases Still Being Grieved at the End of Our Review |
|---|---|---|---|
| **Up to 30 days** | 23 | | |
| **31 days to 6 months** | 16 | 7 | |
| **6 months to 1 year** | 2 | 5 | |
| **1 year to 2 years** | 1 | 5 | 9 |
| **Over 2 years** | | | 5 |
| **TOTAL** | 42 | 17 | 14 |

**Source:** Revenue Canada

In its covering letters for investigation reports, the Directorate began including recommendations to correct weaknesses identified in specific incidents.

**15.71 For those incidents that have significant national implications, Revenue Canada should ensure that remedial action is applied to all organizational units that are at risk.**

***Department's response:*** *Revenue Canada concurs with this recommendation and continues to ensure that remedial actions on incidents that have significant national implications are applied to all affected departmental areas. Cases of misconduct involving financial administration that are reported to the Security Directorate are subsequently provided to the Financial Administration Directorate. In the Financial Administration Directorate, the cases are always reviewed and analyzed. When it is deemed that they have national implications or when it is deemed that a reminder/reinforcement is the appropriate response, financial policies, procedures or guidelines are prepared in the timeliest manner possible. These are disseminated in the form of electronic messages or by memorandum to all Regional Financial Advisors or in the form of a Financial Administration Bulletin to all Revenue Canada offices.*

**The Department does not monitor staff knowledge of expected conduct**

**15.72** Providing information and training to employees does not guarantee that they will understand and do what is expected of them. Employees' lack of understanding of departmental values and standards of conduct increases the risk of their misconduct. Management, therefore, needs to know the extent of employees' understanding in order to adjust, as appropriate, the Department's formal controls, information dissemination and training.

**15.73** Revenue Canada's managers believe that employees understand what kinds of conduct are acceptable. However, many of the employees who were asked during an internal audit indicated that they were not fully aware of the Department's expectations or the consequences of misconduct. Aside from the internal audit, the Department has taken few steps to determine the level of employees' understanding of standards of conduct.

**15.74** Surveys are one way to learn about the knowledge and attitude of employees regarding standards of conduct. Revenue Canada has undertaken few surveys of its employees, however, and none have dealt with the standards of conduct.

**15.75** As part of this audit, we asked managers and other employees three questions about information contained in the booklets on standards of conduct, conflict of interest and security. The first question asked what employees should do upon learning about a security incident. Almost 92 percent of those we interviewed stated that they would notify their manager or security — the correct response. The second question asked about the disclosure of client information. The employees we interviewed tended to be more hesitant about disclosing information than they could be under the law. The third question asked whether departmental employees were treated the same as others who deal with the Department as private individuals. Over 90 percent responded correctly that treatment was the same. While our three questions do not constitute a definitive assessment of the knowledge of departmental employees, they do suggest that more study in this area could provide useful information. The responses to the first and third questions show that a noteworthy minority of employees are unclear about some fundamental rules. Responses to the second question suggest that most employees may be unduly cautious about disclosing information, and

Corrective action taken in one office is not always conveyed to other offices to prevent similar incidents, even when there may be national implications.

A brief, easy to understand and easy to retrieve "code of ethics" document would be a more effective means of communication.

this may be preventing these employees from responding to queries as fully as the Department would like.

**15.76 Revenue Canada should monitor employee knowledge of the Department's expectations for conduct, through the use of staff surveys or other suitable means.**

***Department's response:*** *In the context of the move to Agency status, Revenue Canada will consider various means to monitor employee knowledge of departmental expectations for conduct.*

**Information for staff needs improvement**

**15.77** Information is important not only in permitting the Department to correct systemic weaknesses but also in conveying the Department's expectations to individual employees. Organizational codes of ethics generally endeavour to encourage ethical behaviour by communicating values and guiding principles that employees are to practise in their daily work. The Department's booklet on standards of conduct is more like a code of ethics than the other booklets, although the conflict-of-interest and security booklets and several other related documents also contain information that could be included in a code.

**15.78** Each employee is responsible for acquiring a working knowledge of the information contained in these sources. This is a lot of material for employees to learn in depth. We feel that a brief, easy to understand and easy to retrieve "code of ethics" document, highlighting the key information that employees need to know, would be a more effective means of communication. The material for this document could be extracted from the standards of conduct, conflict-of-interest and security booklets. This is an opportune time to note our concern, since Revenue Canada is currently updating the standards of conduct and security booklets and could easily add a new code of ethics to the initiative.

**15.79** Our wish to see a code of ethics document is also rooted in concerns we have about how information is conveyed in the present booklet on standards of conduct. The opening message from the Deputy Minister could encourage ethical conduct more actively, along the lines of communications we have observed in private sector organizations. Further, the preamble that sets the stage for what follows could better reflect Revenue Canada's mission, vision and values statements. Making a link that demonstrates the consistency between these statements and the standards of conduct would heighten awareness of the importance of ethics.

**15.80** Some of the language in the standards of conduct booklet is excessively legalistic, and this may hamper understanding. Moreover, the booklet focusses on what the standards of conduct are, with very limited discussion of why the standards exist. A statement of the standards unaccompanied by the underlying rationale does not give employees the same encouragement to adopt as their own the values and guiding principles that are the foundation of the standards. This can be critical, since in situations where the application of the standards is not clear-cut, a thorough grasp of the values and guiding principles will enhance the likelihood that an employee will choose the best course of action.

**15.81** Leaving aside matters of content, we also have a concern relating to the distribution of the present set of booklets. Employees certify their understanding of the conflict-of-interest booklet, but only acknowledge the receipt of the booklet on standards of conduct. Because no acknowledgement of the security booklet is required, employees could conclude that the document is of low priority to management. Indeed, when we asked about the receipt of the three key booklets,

fewer employees could recall receiving the security booklet than the other booklets. We believe that the distribution of all three booklets (and, in future, the code of ethics as well) needs to be controlled using procedures that reinforce the importance the Department places on them.

**15.82 Revenue Canada should provide information on values and conduct to its employees in the form of a brief, easy to understand overview ethics document.**

***Department's response:*** *In the context of the move to Agency status, Revenue Canada will examine the development of a briefer, easier to understand information document on ethics, values and conduct.*

**Ethics training is uneven**

**15.83** Providing employees with written information on expected conduct and expecting them to understand it is not a sufficient strategy on its own. This strategy needs to be supplemented by training.

**15.84** There is now no course devoted exclusively to the subject of Revenue Canada's values and standards of conduct. To the extent that they are covered, it is during courses primarily devoted to some operational topic. About 85 percent of the employees we interviewed had received some formal training on ethics; however, the training coverage is uneven. In the orientation course for new customs officers, departmental values are specifically addressed. In contrast, the course for auditors had not been updated to include departmental values as such, though it did refer to concepts that correspond to them. Both courses cover the booklets on standards of conduct and security, but they stress different aspects. Neither course discusses the conflict-of-interest booklet; however, participants are asked to read it. As for the third business line we looked at, Revenue Canada had no national orientation training for new collectors at the time of our review, but some local offices had developed orientation courses. Subsequent to our review, the Department introduced an orientation course for new collectors. In addition, the Department is currently developing a department-wide orientation course for its employees.

**15.85** The time when an employee first joins the Department is a logical point at which to provide training on standards of conduct. Another logical point is when the Department issues new standards. Revenue Canada could have provided training for all of its employees to coincide with the distribution of its three key booklets on conduct. We learned that a few local managers did hold information sessions when they distributed these booklets, but this was not part of a Department-wide initiative.

**15.86** Employees we interviewed want training to occur on an ongoing basis in order to reinforce issues relating to standards of conduct. They need to be reminded of what is and is not acceptable conduct. Our analysis of incidents of misconduct supports the idea that reminders are needed. Over 40 percent of the offenders were veteran employees who should have known what conduct the Department expects of them. Although employees want refresher training, we found that the Department provides it only in the areas of harassment and security awareness.

Of the employees we interviewed, 85 percent have received some ethics-related training; however, training coverage is uneven.

**15.87 Revenue Canada should ensure that all new employees are given uniform training on departmental values and standards of conduct and that veteran employees are given uniform refresher training on departmental values and standards of conduct at appropriate intervals.**

***Department's response:*** *An introductory training course on conduct and values is already in place within the Department for new collections staff at Revenue Canada. The Department will examine the feasibility of expanding this course for*

*presentation to all new staff. It will also examine potential mechanisms for updating veteran staff on these issues.*

## Conclusion

**15.88** In this chapter we considered the various means that Revenue Canada uses to promote integrity among its employees. The Department investigates incidents of potential misconduct, imposes discipline, and corrects control deficiencies highlighted by incidents. In addition, Revenue Canada has published mission, vision and values statements and three key booklets on conduct that seek to describe the kind of culture that the Department wishes to nurture. These publications are supported by training that reinforces some of the main messages, and by an environment that is generally regarded by employees as supportive of the reporting of potential misconduct.

**15.89** All of these means, taken together, form an important foundation for the promotion of integrity in Revenue Canada. However, because of the vulnerabilities it faces, as revealed by the incidents of misconduct that it has experienced, Revenue Canada needs to remain vigilant in promoting integrity.

**15.90** There are certain areas for improvement that will help it to reinforce and build on the solid foundation that is now in place. Discipline is imposed for misconduct; however, the disciplinary process can be slow and this may diminish its effectiveness as a deterrent to similar misconduct. While management takes action to correct weaknesses highlighted by incidents, at times its responses are slow and focussed narrowly on local rather than national weaknesses. Further, although information and training on values and conduct are provided to employees, the information is not presented optimally for ease of understanding, and training is uneven. The Department takes few steps to monitor the level of employees' understanding of values and conduct and the resulting impact on vulnerability to misconduct. Nor does it provide an individual whom employees can consult on a confidential basis on issues of integrity.

# About the Audit

## Objectives

Our audit objectives were to determine whether the Department:

- communicates and promotes compliance with corporate values;
- monitors vulnerability to employee misconduct;
- identifies, investigates and reports incidents of misconduct;
- applies discipline against employees who are guilty of misconduct; and
- analyzes causes of incidents of misconduct or other indications of vulnerability and takes remedial action in response.

## Strategy and Scope

The following diagram, a conceptual framework for total risk, helps explain our audit strategy. It shows three components of total risk: two are the components that reduce risk; the third is the residual risk to which the Department is exposed. The first component that reduces risk is internal controls and internal audit. Internal controls are the traditional methods and measures put into place by management to prevent and detect both error and employee misconduct. Internal audit provides the Department's management with an independent evaluation of certain aspects of its operations.



The second component that reduces risk is compliance with corporate values. Compliance with corporate values is not dictated in the same sense as is compliance with internal controls; rather, compliance comes about through management's actions to convince employees to comply and through the Department's operating as a "social unit".

Residual exposure to risk leaves some potential for incidents of employee misconduct to occur. When employee misconduct is identified, it is investigated and discipline is applied, as necessary. Feedback from the monitoring and analysis of incidents may result in corrective action on internal controls and in means to encourage compliance with corporate values.

We examined how Revenue Canada acts to reduce the risk of employee misconduct by encouraging compliance with corporate values, and the processes that result in corrective actions. The audit did not include a review of internal controls, since there is extensive coverage of them in our other audit work. The examination concentrated, at the operational level, on three business lines (collections, audit and customs) and on certain headquarters functions.

## Approach

We performed a survey using a structured questionnaire, with responses gathered in face-to-face interviews. The purposive sample of 174 employees was selected to achieve representation according to a number of dimensions: (1) position — managers, supervisors and front-line staff; (2) business lines — audit, collections and customs; and (3) location — regions and headquarters. The questions asked in the survey dealt with five areas: information for employees; training; vulnerabilities to misconduct; reporting of incidents; and staff knowledge. In addition to the formal survey, we conducted many free-form interviews, mainly with managers.

We reviewed the documentation relating to all 285 incidents of potential employee misconduct reported to the headquarters Security Directorate from 1 January 1995 to 30 June 1996. We used a standardized data collection instrument to gather information in a manner that would facilitate subsequent analysis. This period was chosen because it was recent enough to ensure that all relevant information would still be on file (in accordance with the Department's records-retention policy) yet old enough that a significant number of cases would have progressed to their final outcomes.

We compared the content of several key departmental publications/documents related to the subject matter of the audit with those of private sector organizations. These were the mission, vision and values statements and the standards of conduct, conflict-of-interest and security booklets/handbooks. We also examined the training materials related to several in-house courses delivered to employees involved in the audit, collections and customs business lines, to determine the extent to which they contained material relevant to the subject matter of our audit.

In addition to the major sources cited above, we reviewed information contained in various other documents and data bases.

The examination phase of this audit was conducted as a collaborative effort between the Office of the Auditor General and the Internal Audit Service Division of Revenue Canada.

## Criteria

We expected to find:

- a stated and visible commitment by senior management to establish and maintain accepted standards of conduct and performance in the Department.
- clear procedures and guidelines mandating and explaining accepted practices and expected conduct and discipline for misconduct, communicated to all employees and updated based on the evaluation of results and experience.
- clear and specific assignment of responsibilities for the prevention, detection and investigation of potential or suspected incidents of breaches in controls and compliance.
- vulnerability assessments conducted by managers to identify, document and prioritize compliance and control risks associated with their areas of responsibility.
- investigation and adequate documentation of potential incidents of non-compliance and of breakdown of controls, followed by appropriate corrective action and disciplinary measures, if needed.
- a comprehensive and reliable reporting system to inform senior management and, as necessary, its staff about the actions taken following incidents and the lessons learned.

## Audit Team

Assistant Auditor General: Shahid Minto
Principal: James Ralston
Director: Victoria Saunderson

Paul Chabot
Anne Hardy
Mimi Hong
Catherine Johns
Paul Reed
Alex Rennie

For information, please contact James Ralston.

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## Chapter 16
## Management of the Social Insurance Number

**September 1998**

# Report of the Auditor General of Canada to the House of Commons

## Chapter 16
Management of the
Social Insurance Number




# September 1998

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# Chapter 16

## Management of the Social Insurance Number

*The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.*

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# Management of the Social Insurance Number

## Main Points

**16.1** The Social Insurance Number (SIN) was implemented in 1964, to provide Unemployment Insurance, Canada Pension Plan and Quebec Pension Plan clients with a file number. In 1967, it also became a file identifier for Revenue Canada. From the outset, the SIN was the subject of intense parliamentary interest and debate. The controversy focussed largely on the implications of a potential expansion of its use to become a universal identifier. The history of the SIN has mainly reflected the tension between balancing the often competing objectives of maintaining individual privacy and improving administrative efficiency and effectiveness.

**16.2** Human Resources Development Canada has been administering the SIN in accordance with the intent of its legal framework whereby the SIN is intended to be a file identifier (account number) for certain federal government programs. However, the public often perceives the SIN to be a personal identifier or even an identity card.

**16.3** The use of the SIN outside the federal domain has evolved beyond the intent of the Treasury Board policy established in 1989, aimed at preventing it from becoming a national personal identifier. Our audit found that the SIN has become the common numerical identifier both inside and outside the federal government for a wide range of income-related transactions and benefits, among other uses.

**16.4** Changes to the *Income Tax Act* and Regulations have increased the use of the SIN at the provincial/territorial level and in the private sector, as have the growing number of data exchanges, comparisons and matches among various tiers of social programs.

**16.5** However, the SIN has a number of weaknesses. Some of them are well known. As the use of the SIN has become more widespread, these weaknesses have grown in importance. They include the following:

- The information on SIN holders, particularly on births and deaths, is not always complete and accurate.
- Existing SIN application procedures are insufficient to guard against fraud and abuse. Holders of 11.8 million SINs who registered prior to the introduction of the proof-of-identity program in 1976 have not been asked to provide proof-of-identity documentation. This exacerbates the risk of misrepresentation.
- The provinces and financial institutions are required by the *Income Tax Act* and Regulations to collect SINs for tax purposes but cannot validate the SIN numbers provided by their clients.
- SIN errors, abuse, and misuse affect many federal programs, provinces and the private sector. Collectively, the impact may be sizable.
- Minimal effort is dedicated to investigations of SIN fraud and abuse, and penalties are minimal, with no real impact on deterrence.
- Unregulated use in the private sector, except in Quebec, makes it vulnerable to abuse in terms of both privacy and fraud.

## Main Points (cont'd)

**16.6** The effectiveness of certain administrative decisions as well as the integrity of social programs are greatly facilitated by the reliability of the information contained in the SIN data base. We believe it is time to review the current roles, objectives and uses of the SIN in light of its governmental and societal importance. The government needs to clearly state the level of integrity and privacy protection expected in the system.

**16.7** There appear to be two options: improve the existing framework to catch up with the current reality of SIN usage or else devise an acceptable alternative solution to meet the needs of users, including governments and individuals. In any case, the privacy implications need to be recognized. In our view, it is essential that Parliament play a major role in debating these issues, increasing public awareness, and finding a satisfactory solution.

# Introduction

## The Social Insurance Number Was Created in 1964

**16.8** When Prime Minister L. B. Pearson stood in the House of Commons in April 1964 to announce that the government intended to introduce the new Social Insurance Number (SIN), he may not have realized how deeply he was affecting the way Canadian social programs would be administered in the years to come. At the time, the need to introduce the SIN was twofold. First, the Unemployment Insurance registration system was running out of numerical combinations to identify its clients. Second, the new Canada and Quebec Pension Plans would require a national system to register and identify contributors and recipients.

**16.9** In the early sixties, the Royal Commission on Government Organization (also known as the Glassco Commission) concluded that "a numbering system that could be used to identify individuals for all purposes would contribute significantly to improved efficiency, both in government and outside." In response, there were several interdepartmental discussions about using the SIN as a common identifier to achieve savings and avoid the confusion that could arise if various departments used their own numbering schemes. The first name contemplated for the new number was the *Canada Account Number,* reflecting an intention to use it in all financial transactions between the government and individual citizens.

**16.10** However, political pressures influenced the government of the day to restrict the use of an identifying number instead of expanding it. Thus the *Social Insurance Number* was born, and it was presented in the House of Commons as an initiative restricted to Unemployment Insurance and the Canada and Quebec Pension Plans.

## The Role of the Social Insurance Number Has Expanded Gradually

**16.11** Despite the emphatic statements made in the House of Commons in 1964, the federal government proceeded in the following years to incrementally expand the scope of the SIN. In 1967, the *Income Tax Act* was amended to authorize the use of the SIN on tax returns — a critical extension. In 1976, the *Income Tax Act* was amended again to require that individuals cashing Canada Savings Bonds provide their SIN. Insurance companies and financial institutions then started collecting their clients' social insurance numbers for tax purposes.

**16.12** As an array of data bases were created in the 1970s and 1980s to administer various government programs, the SIN was adopted instead of each time creating a new user number or client number. Today, over 20 federal statutes, regulations and programs authorize the use of the SIN (see Exhibit 16.1 for a detailed list). Its use expanded gradually to provincial social programs and, in the private sector, to the many companies that use the SIN to identify their employees and their clients. Some of these uses, which are unofficial, were not anticipated in the legislation and therefore are not explicitly or implicitly prohibited.

**16.13** The increasing use of the SIN has growing implications for program integrity and privacy protection. It is used by many federal and provincial government departments as one of the key tools in managing the programs that require precise identification of payers, claimants or recipients. It is used as an identification number to verify benefit entitlement, to collect and add information to clients' files and to match and exchange data among programs. Generally, people must have a SIN to work and to collect Employment Insurance benefits, Canada

The increasing use of the SIN has growing implications for program integrity and privacy protection.

The widespread use of the SIN considerably increases its potential for fraud and abuse, as well as the variety and extent of the illegal activities to which it gives rise.

Pension Plan payments, and tax refunds, benefits and credits.

**16.14** It is critical to link the SIN with its rightful owner. When this linkage does not occur, payments of benefits, pensions and credits and collection of income tax could be in error.

**16.15** Each SIN number entails collecting birth, name change and death data, along with citizenship status, which can act as an additional cross-check in determining identity and eligibility for programs. Accurate information in the SIN data base is important for both service and control.

**16.16** The SIN has obvious potential as a tool for facilitating the joint delivery of services in income security programs, given its now widespread use as a client identifier in such programs. Both Human Resources Development Canada (HRDC) and the Treasury Board have considered using the SIN as one means to streamline service delivery.

**16.17** The widespread use of the SIN considerably increases its potential for fraud and abuse, as well as the variety and extent of the illegal activities to which it gives rise. Exhibit 16.2 shows how diverse and pervasive abuses of SIN can be. The cost to the government and to society in general could be significant.

## Roles and Responsibilities Are Dispersed

**16.18** In the federal government, the roles and responsibilities for the SIN are dispersed. HRDC is the custodian of the SIN: it is responsible for issuing SINs,

Exhibit 16.1

**Authorized Uses of the Social Insurance Number (SIN)**

| Statutes and Regulations |
|---|
| 1. *Budget Implementation Act* (Canada Education Savings Grants) |
| 2. *Canada Elections Act* |
| 3. Canada Labour Standards Regulations (Canada Labour Code) |
| 4. Canada Pension Plan Regulations (Canada Pension Plan) |
| 5. *Canada Student Financial Assistance Act* |
| 6. Canada Student Loans Regulations (*Canada Student Loans Act*) |
| 7. *Canadian Wheat Board Act* |
| 8. *Employment Insurance Act* |
| 9. *Excise Tax Act* (Part IX) |
| 10. Garnishment Regulations (*Family Orders and Agreements Enforcement Assistance Act*) |
| 11. *Farm Income Protection Act* |
| 12. Gasoline and Aviation Gasoline Excise Tax Application Regulations (*Excise Tax Act*) |
| 13. *Income Tax Act* |
| 14. *Labour Adjustment Benefits Act* |
| 15. Old Age Security Regulations (*Old Age Security Act*) |
| 16. Tax Rebate Discounting Regulations (*Tax Rebate Discounting Act*) |
| 17. Veterans Allowance Regulations (*War Veterans Allowance Act*) |
| **Programs** |
| 1. Income and Health Care Programs (Veterans Affairs Canada) |
| 2. Immigration Adjustment Assistance Program (Citizenship and Immigration Canada) |
| 3. Labour Adjustment Review Board (Human Resources Development Canada) |
| 4. National Dose Registry for Occupational Exposures to Radiation (Health Canada) |
| 5. Rural and Native Housing Program (Canada Mortgage and Housing Corporation) |
| 6. Social Assistance and Economic Development Program (Indian and Northern Affairs Canada) |
| 7. Income Tax Appeals and Adverse Decisions (Revenue Canada) |

**Source:** Department of Justice and Treasury Board Secretariat, June 1998

maintaining the Social Insurance Register (SIR), investigating suspected abuse, and making regulations if necessary. The Treasury Board is responsible for the policy and guidelines that govern the collection and use of the SIN at the federal level, including data matching. The Office of the Privacy Commissioner, an independent oversight agency, investigates complaints about the SIN, reviews compliance with the *Privacy Act* and reports to Parliament. The Department of Justice supports other departments in providing legal advice for SIN-related questions arising under the *Privacy Act,* and responds to general inquiries from the public on the private sector's use of the SIN.

## Focus of the Audit

**16.19** The objective of our audit was to assess the management and control of the SIN to determine if it is efficient and effective and has an appropriate basis in legislation. We examined the role and use of the SIN in managing social programs and revenue collection; the application process; the management of the SIR; and the investigation of fraud and abuse. In addition to examining activities at HRDC, we interviewed officials and reviewed relevant documentation at Revenue Canada, Citizenship and Immigration Canada, the Treasury Board Secretariat, Industry Canada, the Department of Justice, the Royal Canadian Mounted Police, the Office of the Privacy Commissioner, Elections Canada, the Canadian Passport Office and many provincial organizations. We performed extensive analyses of the SIN data base provided to our Office by HRDC. We also talked to privacy experts and other organizations with interests in the SIN.

**16.20** Further details on the audit objectives, scope and criteria are

Exhibit 16.2

Types of SIN Abuse

**Federal, Provincial and Municipal Social Programs**

- Obtaining benefits from Canada Pension Plan, Quebec Pension Plan, Employment Insurance and social assistance using different names or while working under another identity.
- Using many identities to collect Old Age Security cheques.
- Fabricating a new identity and obtaining a student loan.
- Obtaining credit for grants or sales tax credits using different names.
- Obtaining many health cards.

**Federal and Provincial Income Tax**

- Splitting income or obtaining various tax credits by using several names.
- Using many identities to hide investment income.

**Work Permits and Licenses**

- Obtaining work permits using different names.
- Obtaining a replacement driver's license under a different identity.

**Commercial Activities**

- Obtaining many credit cards or many lines of credit using different names, and disappearing once the maximum credit limit on all of them has been reached.
- Securing loans in banks using faked identification and subsequently disappearing.
- Making term deposits using different names.
- Renting luxury cars with the intent of selling them in foreign countries and subsequently disappearing under a new identity.

**Source:** HRDC and Office of the Auditor General of Canada

presented at the end of the chapter, in the section entitled **About the Audit**.

## Observations and Recommendations

### Importance of the SIN

**The SIN has become a de facto national identifier for income-related transactions, contrary to the government's intent**

Today, almost any transaction related to an income support payment or loan, revenue collection, and an individual's personal finances has a SIN attached to it.

**16.21** The federal government sought in 1988 to restrict use of the SIN in its programs by developing the current policy on the control and use of the SIN and data matching. This policy was developed in direct response to recommendations arising from the review of access to information and privacy legislation that was conducted in 1986 and 1987 by the Standing Committee on Justice and Solicitor General. The government clearly indicated that its intention was to prevent the use of the SIN as a national personal identifier in order to protect individual privacy. For instance, it limited the federal use of the SIN to the administration of tax, pension, social and benefits programs, along with programs authorized under a few federal statutes (such as the *Employment Insurance Act*).

**16.22** For example, the federal government stopped using the SIN on citizenship forms. It eventually deleted the SIN from many data bases and stopped using it to identify its own employees. It indicated that any new uses in the federal government would require parliamentary approval. However, it did not address the growing use in the private sector and by the provinces, territories and municipalities. Nor did it anticipate the impact that amendments to the *Income Tax Act* and Regulations would have as they began to require a SIN for more types of financial transactions and benefits.

**16.23** In 1992, the Income Tax Regulations were amended to require that provinces include the SIN on T5007 tax slips issued to all recipients of social assistance and workers' compensation payments. This virtually guaranteed the dominance of the SIN as the common program identifier for provincial and municipal social programs. With similar programs at the federal level (Employment Insurance, Old Age Security and Canada Pension Plan), together they constitute a cluster of programs representing close to $100 billion in annual payments — 26 percent of all government expenditures in Canada.

**16.24** The recently announced Canada Education Savings Grant will require that a new population (an estimated 1 million out of 7 million children) obtain a SIN in order to receive government grants, and to satisfy requirements of the *Income Tax Act* and Regulations. Today, almost any transaction related to an income support payment or loan, revenue collection, and an individual's personal finances has a SIN attached to it. The growing importance of the SIN has shown little sign of abating, despite government intentions to the contrary.

**A common numerical identifier is important in the growing number of data matches**

**16.25** Data matching is defined by the Treasury Board as the comparing or linking of personal information obtained from different sources for the purpose of making decisions that could affect the individuals to whom the information pertains. Data comparisons for other purposes such as research are not considered to be "data matches" under the Board's definition.

**16.26** The growing use of data matching, comparison and exchange between and among jurisdictions in administering social programs has been greatly facilitated by the use of the SIN. Using a numerical identifier is often seen

as the most practical and efficient way to match personal data, because of its uniqueness and universality. Other personal identifiers or any combination thereof could be used, such as date of birth, surname, name, gender and/or address. However, a recent study done by Elections Canada indicates that more than 10 percent of Canadians have the same family name and date of birth as at least one other Canadian. Also, people do not always report their names consistently, and names can be misspelled. Further, 16 percent of Canadians aged 18 or older move each year. Information can also be recorded in different file formats. All of these factors complicate data matching without a numerical identifier.

**16.27** Most data matching in the federal government uses the SIN as the core personal identifier for matching information from two data bases. The Old Age Security (OAS) program showed the benefit of using the SIN. The difficulty of managing the files among programs such as the Canada Pension Plan (CPP), OAS, and International Agreements for OAS and of matching their data without a SIN led HRDC to launch an initiative to assign SINs to all beneficiaries. Provincial social services programs we visited also use the SIN extensively to validate client lists among their various jurisdictions. For them, having a common element like the SIN is important because of incompatibility among the different systems. Other identifiers such as health card numbers and driver's license numbers are unique, but are specific to each province. Thus, unlike the SIN, they cannot be used for interprovincial data matches or for matches between federal and provincial social programs such as Employment Insurance and social assistance.

**16.28** Our review of current data matches at HRDC that use the SIN as a common identifier indicated that they achieve significant savings through avoidance of overpayments, recovery of overpayments and debts, and administrative efficiencies. For example, HRDC's Computer Post-Audit program matches employment insurance claims with records of employment information to identify persons who are collecting benefits but are not reporting or are underreporting their earnings. For fiscal year 1996–97, this data-matching activity alone generated about 570,000 investigations that identified overpayments of $102 million and resulted in penalties totalling $50 million.

## Integrity of Data in the Social Insurance Register

### The Social Insurance Register: 33 million SINs issued

**16.29** The Social Insurance Register (SIR) is the register that records the personal information provided by individuals when they apply for a SIN. It contains all the SINs and key basic personal information such as dates and places of birth and death, and mother's and father's names. Certifying, registering, issuing and keeping track of millions of SINs is a complex task, undertaken on a very large scale. A total of more than 33 million SINs have been issued since 1964. National Services, a branch of HRDC that operates out of Bathurst, New Brunswick, manages the SIR and issues about one million cards (new and replacement) each year. Its annual operating costs are $7 million, $2 million of which is collected from applicants for replacement cards. The remaining $5 million in costs is divided among the original users of the SIN — Revenue Canada, CPP, the Quebec Pension Plan and the Employment Insurance Account — who share operational responsibility for the integrity of the data bank. Our audit work showed that the SIR is generally well protected and physically secure.

Certifying, registering, issuing and keeping track of millions of SINs is a complex task, undertaken on a very large scale.

There are 311,000 people aged 100 years or older who are considered in the Social Insurance Register (SIR) to be alive, while only 3,000 are recorded in the Statistics Canada census.

**Significant gap between number of living SIN holders and size of the Canadian population**

**16.30** Stakeholders have raised concerns about the high number of living SIN holders in the SIR compared with the size of the Canadian population: a gap of about 3.8 million for those aged 20 or older, the age at which most Canadians have obtained a SIN (see Exhibit 16.3). Various factors could account for the gap: the number of Canadians and non-Canadians who have left the country, deceased SIN holders whose deaths have not been reported to HRDC, and SINs based on fraudulent identities. Since the gap cannot be reconciled with any certainty, it represents a risk of increased error, abuse and misuse of the SIN that could allow inappropriate access to federal and provincial programs.

**16.31** Our audit work included analytical testing of the 33 million records, provided to us by HRDC. We found that the number of unrecorded deaths is one of the biggest factors in the gap. From 1965 to 1990, only 1 million deaths were registered in the SIN data base, far below the 4.4 million deaths in the Canadian population for the same period. Since 1993, SIR has obtained information about deaths using additional data from other sources such as CPP, Revenue Canada and the Régie de l'assurance-maladie du Québec (RAMQ). During the period 1991 to 1997, over 2.6 million deaths were registered in the SIN data base, a dramatic improvement (see Exhibit 16.4).

**16.32** The collection of death data still needs to be improved, however. The number of living Canadians registered in the SIN data base in 1998 remains significantly higher than in Statistics Canada data. For example, the 1998 data base shows 771,000 persons aged 90 and older who have an active SIN, compared with the 127,000 individuals (less than one sixth) shown by Statistics Canada's data for this age group. More striking is the comparison of 311,000 people aged 100 years or older who are considered to be still alive, according to the SIR, with only 3,000 recorded in Statistics Canada census data.

**16.33** Without additional efforts to record deaths, the gaps will continue to grow, along with the potential for confusion and inefficiency and the risk that the identities of deceased individuals could be used for fraudulent activities. While other federal programs collect death data, they do so only for their target

Exhibit 16.3

Comparison of Social Insurance Register and Statistics Canada Data on the Number of Living Individuals Aged 20 or Older

| Age | Social Insurance Register | Statistics Canada | Difference |
|---|---|---|---|
| | Number of SINs[1] | Actual Population[2] | |
| 20 – 29 | 4,258,017 | 4,237,481 | 20,536 |
| 30 – 39 | 5,541,599 | 5,270,366 | 271,233 |
| 40 – 49 | 5,466,430 | 4,649,732 | 816,698 |
| 50 – 59 | 4,093,556 | 3,176,758 | 916,798 |
| 60 – 69 | 2,746,661 | 2,351,296 | 395,365 |
| 70 – 79 | 2,091,465 | 1,729,139 | 362,326 |
| 80 – 89 | 1,084,768 | 728,261 | 356,507 |
| 90 and over | 770,871 | 127,095 | 643,776 |
| **Total** | **26,053,367** | **22,270,128** | **3,783,239** |

**Source :** [1] HRDC, Social Insurance Register, 31 March 1998
[2] Population estimates on 1 July 1997, according to Statistics Canada

population and the data are not always complete. For instance, about a third of the approximately 3,000 frauds detected by Income Security Programs at HRDC since 1985–86 pertained to cheques negotiated after the eligible recipient's death.

**Existing sources of information are not fully exploited and more could be done to develop new sources**

**16.34** In 1996, Revenue Canada provided death update files to SIR three times. In 1997, it was agreed that this information would be sent only once a year. The comparison between SIR and RAMQ data demonstrated that similar comparisons with other provincial health insurance programs, which are not undertaken at present, could potentially reveal hundreds of thousands of unreported deaths. Vital statistics bureaus in the provinces, territories and foreign jurisdictions are other potential sources of information. However, as most of them do not use the SIN, sharing data would be difficult.

**16.35** Even though CPP, Revenue Canada and SIR are sharing more data, the problem of reconciling the various sources remains. For example, Revenue Canada does not provide SIR with corrections it makes to its taxpayer files when it notes discrepancies in date of birth, name, etc. Revenue Canada informed us that the income tax system and the various credits and benefits administered by Revenue Canada rely heavily on an individual's SIN but less on such items as date of birth or name. As a result, non-critical variations in those parts of an individual's data record are accepted with less verification than would be required by SIR.

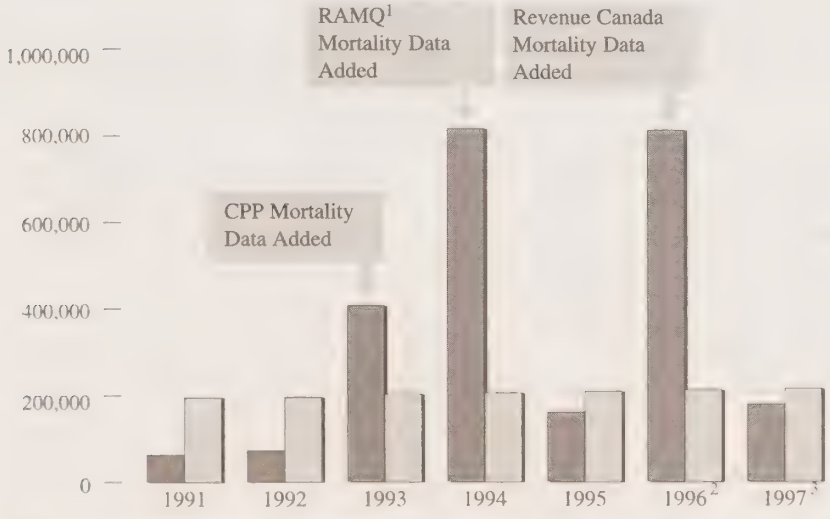
**Millions of SINs are not certified for identity**

**16.36** In 1976 a proof-of-identity program began that required applicants for a SIN to provide identification documents. As of March 1998, the Social Insurance

We found that there are approximately 11.8 million uncertified accounts in the SIR that could be sources of potential error, misuse and abuse.

Exhibit 16.4

**Comparison of Mortality Data Recorded in Social Insurance Register and Reported by Statistics Canada**




[1] Régie de l'assurance maladie du Québec
[2] Revised
[3] Preliminary

**Note:** Data added to SIR in 1993, 1994 and 1996 include missing death data for prior years.

**Source:** HRDC and Statistics Canada

Register contained 16.8 million SIN entries that had not been supported with identification documents. This represents 51 percent of SINs issued. However, some of the uncertified records do not need to be validated — where the individual is deceased or the SIN has been cancelled, voided, or validated by other programs. This leaves approximately 11.8 million uncertified accounts in the SIR that, because of the potential for error, misuse and abuse, should cause major concerns to those who make significant use of the SIN, such as Revenue Canada and all income security programs.

**Birth-related information is not easily validated with the issuing organizations**

**16.37** Accurate birth information is as important as death information to the integrity of the SIN data base. SIR does not generally confirm the validity of information shown on documents accepted for SIN applications with the organizations that issued them. For example, SIR does not validate information on birth certificates (existence, date and place of birth, parents' names, or whether the individual is deceased) with information in provincial and territorial vital statistics registries.

**16.38** The urgent need to resolve this issue is highlighted by comparisons we made between OAS and SIR data bases and between CPP and SIR data bases. These comparisons were performed in 1998 and showed discrepancies of four to five percent in their birth data. The gap in the date of birth between SIR and OAS/CPP data bases is 22 months on average, with a maximum of 50 years. These discrepancies affect 166,000 OAS files and 98,000 CPP files.

**16.39** The difficulty of validating birth-related data with vital statistics is well known and long-standing. HRDC is currently conducting a pilot project with the New Brunswick government that allows on-line verification of birth and name change information provided by SIN applicants. The SIN applicant's information is also verified on-line with the province's death registry to ensure that the individual has not been reported deceased. Extending this project to other provinces and territories could enhance the reliability of the SIN data base, although privacy implications would need to be assessed. As well, provinces, territories and the federal government may not yet be technologically compatible.

**16.40** Applications based on Citizenship and Immigration Canada documentation for new SINs, replacement cards and status changes represent one third of SIR annual workload. SIR now has an on-line connection with Citizenship and Immigration Canada's information system. Data in the system can be accessed quickly to validate the information provided by applicants.

**16.41** By validating the information on birth certificates and other documents with the organizations that issued them, SIR could eliminate errors in the information it registers on SIN holders. It could also reduce the risk of issuing SINs to impostors whose applications are supported by fraudulent or modified documents. Since the information contained in the SIR is considered personal, HRDC has a legal requirement to take all reasonable steps to ensure its reliability. Section 6(2) of the *Privacy Act* requires government institutions to ensure that personal information being used for an administrative purpose is as accurate, complete and up-to-date as possible. As noted earlier, HRDC has made some efforts in this direction. However, it does not have in place a comprehensive plan to ensure that SIR information meets this requirement.

**16.42 Human Resources Development Canada, in co-ordination with its partners, should ensure where appropriate that available information from federal and provincial programs is**

**used effectively to improve the integrity of the Social Insurance Register.**

**16.43 Human Resources Development Canada should develop a comprehensive plan with appropriate targets and time frames and clear statements of roles and responsibilities to bring the reliability and completeness of the data in the Social Insurance Register to an appropriate level.**

***Human Resources Development Canada's response:*** *HRDC agrees with both recommendations. HRDC recognizes the importance of improving the integrity of the Social Insurance Register and will increase its efforts to work with other federal partners, the provinces and the territories to obtain the information required to achieve the desired level of integrity. HRDC will, in co-operation with its partners, develop an appropriate federal-provincial strategy and action plan. Even though they may want to provide personal information, the provinces and territories may need to amend their privacy legislation and may also have to make substantial system changes.*

### Valid SINs are held by thousands of individuals with no legal status in Canada

**16.44** The SIR issues temporary SINs (900 series) to non-permanent residents such as refugee claimants, seasonal workers and foreign students, based on immigration documents that eventually expire. A 900-series SIN can also be issued to any citizen of another country, even if he does not reside in Canada, for such reasons as opening a bank account or investing in Canada. If those SIN holders obtain permanent residency in Canada, they are entitled to change their 900-series SIN for a regular SIN. The observed tendency is for people to request the regular SIN quickly after gaining permanent residency, since it is perceived as more valuable. Since 1976, when the 900 series began, 1,242,000 temporary SINs have been issued. In 1998, some 680,000 temporary SINs remain active and 66 percent of these are over five years old, a long period of time for a number considered temporary. The number of temporary SINs issued is 470,000 higher than the 210,000 non-permanent residents reported by Statistics Canada in 1997. Since the SIN has no expiry date, this difference could include SIN holders who have left Canada. If SIR has not been formally advised of a departure, there is a risk that the 900-series SIN with no expiry date could be given, rented or sold to another individual.

The number of temporary SINs issued is 470,000 higher than the 210,000 non-permanent residents reported by Statistics Canada in 1997.

**16.45** Alternatively, the gap could represent SIN holders who are residing here illegally. For example, a 1994 Revenue Canada estimate showed that thousands of individuals who were using their SIN to work or obtain social assistance or tax credits had no legal status in Canada, according to Citizenship and Immigration Canada's records. Out of 80,000 individuals with a 900-series SIN who collected Goods and Services Tax (GST) credits in January 1993, Revenue Canada estimated (based on a sample of about 3,600) that 32 percent could have received benefits to which they were not entitled. Revenue Canada estimated that the potential loss on GST credits could be as high as $8.2 million. Revenue Canada also noted that the reported source of income of many of these individuals was social assistance. Therefore, losses by provincial and municipal governments could potentially have been substantial. We realize that this issue may be difficult to resolve because it could possibly involve reconciling mandates of departments involved as well as the confidentiality provisions of the *Income Tax Act* and the requirements of the *Privacy Act*.

**16.46 Human Resources Development Canada, in conjunction with Revenue Canada and Citizenship and Immigration Canada, should address**

**the risks associated with the issuance of temporary SINs that have no expiry date.**

***Human Resources Development Canada's response:*** *Agreed. HRDC is establishing a working group mandated to address the risks associated with the issuing of temporary 900 series Social Insurance cards that have no expiry date. Citizenship and Immigration Canada and Revenue Canada have already indicated their willingness to participate.*

***Revenue Canada's response:*** *Agreed. Revenue Canada will participate with Human Resources Development Canada and Citizenship and Immigration Canada, in a co-operative effort, to decrease the risks associated with the issuance and retention of temporary SINs, recognizing that there may be legislative constraints limiting the exchange of certain information in this exercise.*

***Citizenship and Immigration Canada's response:*** *Agreed. Citizenship and Immigration Canada (CIC) has a number of working arrangements with Human Resources Development Canada and Revenue Canada (RC) to address issues of mutual concern, including the use of the SIN. CIC will renew its efforts, in conjunction with RC and HRDC, to address the risks associated with the lack of expiry date on temporary SINs.*

We noted that the SIR compensates for the risks associated with mailed applications through its screening procedures as well as specialized tests and controls.

## Processing and Control of the SIN

### More rigour needed in the proof-of-identity program

**16.47** There are two ways of submitting an application for a SIN: in person at a local Human Resource Centre of Canada (HRCC) or by mail. The applications submitted to HRCCs are reviewed by agents who examine proof-of-identity documents, which are usually originals. The applications found to be in order are certified by agents and forwarded to National Services in Bathurst. Individuals can also mail SIN applications directly to Bathurst. There, direct mail applications are reviewed by SIR staff for accuracy and completeness, and the proof-of-identity documents (original or a certified copy) are examined. SIR operators review each application received from HRCCs and in the mail. If there are no internal inconsistencies or omissions, the application is accepted for processing.

**16.48** Different kinds of documents are accepted as proof of identity, depending on the status of the person applying for a SIN card. Canadian citizens can provide a birth certificate issued in Canada or a citizenship card issued by Citizenship and Immigration Canada. Permanent residents must present their Record of Landing. Temporary residents must present immigration documents that authorize them to remain in Canada for a specified period of time.

**16.49** Generally, the SIN application process asks for only one identity document and does not have other means to confirm identity. We compared SIN requirements with those of other HRDC programs as well as the Passport Office. We found that these other programs had additional controls to verify the identity of applicants (see Exhibit 16.5).

**16.50** In general, mailed applications represent a somewhat greater risk than in-person applications, because certified photocopies are accepted — which themselves could have been certified fraudulently — and applicants who raise suspicion cannot be questioned. At present, mailed applications represent only 10 percent of the applications processed in Bathurst, one of the smallest mail intake ratios of the programs shown in Exhibit 16.5. We noted that the SIR compensates for the risks associated with mailed applications through its screening procedures as well as specialized tests and controls; this leads to a rejection rate of about 30 percent.

**16.51** The risks associated with mailed applications remain significant, however. An HRDC investigation of SIN cards sent

to mail drops in a region identified 37 suspect SIN applications. Further analysis showed that 10 of those were based on falsified documents and the individuals did not exist in a provincial vital statistics registry. In another case of fraud, an investigation revealed that a man had obtained 72 SIN cards using the identities of deceased children; those applications had been mailed directly to Bathurst.

**16.52** About 20 percent of total SIN cards issued annually are to replace cards that owners have reported lost, stolen or broken. Controls on this activity need to be improved. If a certain number of replacement cards have been issued to an applicant within 12 months, a request for an additional card automatically triggers an investigation. But other warning signs, such as a number of cards mailed to the same address, are not used to monitor potential fraud.

**16.53** In looking for best practices, we found that the Passport Office has a more comprehensive proof-of-identity program. It has compiled all the possible variations of birth certificates among the 12 provincial and territorial jurisdictions and makes this information available to its front-line clerks. For each application, it also requires one guarantor whose status can be checked. It maintains a list of potentially fraudulent users against which new applications are compared. It has selected a validity period of five years (compared with 10 years for similar documents in most other countries). The Passport Office also favours in-person applications over those mailed in (which represented only 10 percent of applications in 1997–98). Moreover, the Canadian passport contains several security features. However, the Passport Office shares the concerns about birth certificates and other primary documents discussed in the following paragraphs.

### Relying mainly on the birth certificate as the foundation of identity has major drawbacks

**16.54** One document is generally required to apply for a SIN. The document

Exhibit 16.5

**Comparison of Proof-of-Identity Requirements for a SIN Application and Selected Programs – 1998**

| | SIN | Canada Pension Plan | Old Age Security | Employment Insurance | Passport Office |
|---|---|---|---|---|---|
| One document to support identity (e.g. birth certificate) | Yes | Yes | Yes | Yes[1] | Yes |
| Additional document(s) or other means to support identity | No | Yes[2] | Yes[3] | Yes[4] | Yes[5] |
| Certified copy accepted | Yes | Yes | Yes | No | No |
| Mail-in applications | 10% | 90% | 90% | 10% | 10% |
| In-person applications | 90% | 10% | 10% | 90% | 90% |

**Source:** HRDC and Canadian Passport Office

[1] A record of employment issued by the former employer supports the application.

[2] HRDC uses the CPP records of contributions to confirm identity.

[3] HRDC uses the CPP records of contributions to confirm identity. For those who have not contributed, only one identity document is required.

[4] One or two additional identity documents are required for in-person applications.

[5] An eligible guarantor signs the application.

There are up to 37 documents that can be accepted for SIN applications.

most fundamental to obtaining a SIN is the birth certificate, issued by the provinces and the territories. The birth certificate has the following limitations. It is:

- easy to obtain — television programs, various books and even Internet sites provide instructions for obtaining birth certificates to create false or multiple identities;
- relatively easy to forge or alter, especially for older certificates, given the current technology for colour duplication;
- paper-based, so it deteriorates rapidly, making information harder to verify; and
- not linked to the bearer through any special security features.

However, it is much more difficult to falsify the initial application to register a birth.

**16.55** A research study prepared for the Federal/Provincial/Territorial Working Group on Common Client Identifiers and released in the spring of 1997 noted that those weaknesses are shared by a number of Canadian identity documents considered acceptable for obtaining a SIN. The noted weaknesses are most problematic in birth certificates, however, as they are often used to obtain other identification that is considered more secure because it carries a photograph (driver's licenses and health cards, for example). Widespread reliance on documents issued by various agencies creates an interdependence (A relies on B who relies on C who relies on A). This makes all parties more vulnerable. For example, with a SIN and a birth certificate, the bearer has access to a number of social programs. We noted that a birth certificate with a SIN is also acceptable for OAS applications. The HRDC Income Security Programs Branch, which is responsible for OAS, has not assessed the reliability of this document.

In provincial programs, the SIN plays a key role in establishing the identity of a person applying for services.

**16.56** For the SIN, the extent to which the identity document is validated depends on the ability of HRDC clerks and agents to recognize fraudulent or falsified documents. The large number of documents accepted by the Department in support of SIN applications makes this task even more difficult. There are up to 37 types of documents that can be accepted and, moreover, among the 12 provincial and territorial jurisdictions there are several variations of birth certificates. Design changes in documents, lack of photographs, the mobility of individuals who may be carrying identification produced in many different jurisdictions, all make it increasingly difficult for program staff who review documents to identify forgeries or altered information. As well, the reliability of these documents is not given a rating and so the Department's approach is not tailored according to the quality of identity documents provided by issuing organizations.

**16.57** In provincial programs, the SIN plays a key role in establishing the identity of a person applying for services, either through examination of the presented SIN card or by data matching using the number. The SIN card is accepted as original proof of identity in five of the eight provincial programs we reviewed.

**16.58** The SIN card was not designed to identify the bearer. Thus, the SIN card has no security features that are unique to the bearer (photograph, description, or other characteristics such as fingerprints and retinal scan) and that could serve to prevent and deter falsification and improper use of the card (see Exhibit 16.6 for some of these security features).

**16.59 Human Resources Development Canada should:**

- **update the proof-of-identity program, not reviewed thoroughly since its inception in 1976, to make it more**

**rigorous and more compatible with the other programs it supports;**

- **assess the reliability of identity documents used to support applications for a Social Insurance Number and its other programs such as Canada Pension Plan and Old Age Security, and implement corrective measures where necessary; and**
- **investigate the feasibility of either upgrading the security features on the Social Insurance card or dispelling perceptions that it is an official proof of identity.**

***Human Resources Development Canada's response:*** *Agreed. HRDC will review the process for SIN applications with a view to strengthening the proof of identity required of applicants. In*

Exhibit 16.6

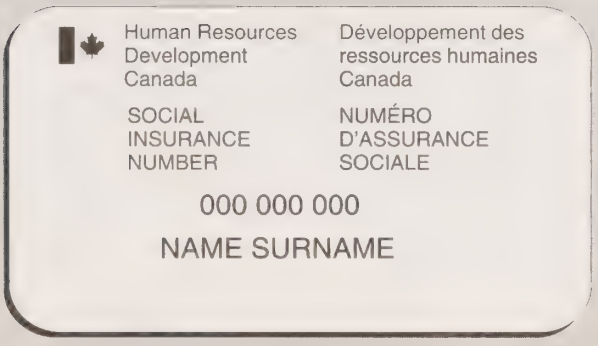
**Technological Innovations That Could Be Used to Improve the Social Insurance Card if It Is to Be Used as an Identity Card**

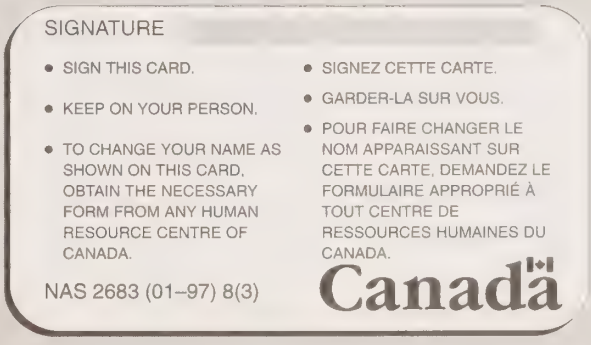
**Smart Card Features**

- Contain a central processing unit
- Have the ability to store and secure information
- Have the power to make decisions
- Use read/write capabilities

**Security Features**

- Encryption
- Security key such as personal identification number (PIN)
- Biometrics locks
- Digital signature
- Micro characters
- Hologram
- Bar code
- Magnetic strip
- Secondary security keys (cryptographic algorithm)
- Redundant security systems
- Ultimately tamper-proof technology thanks to an embedded chip




**Biometrics Features**

- Hand geometry
- Retina/iris scanning
- Finger scanning
- Photograph
- Signature
- Voice pattern recognition

**Source:** Various Reports and Studies

*addition, HRDC agrees to review proof-of-identity requirements in respect of applicants for HRDC benefit programs. HRDC emphasizes that the Social Insurance card is not and was never intended to be an identity document. However, HRDC recognizes that the card might nonetheless be used in this way and agrees to study what might be required to ensure proper usage of the card in light of government policy concerning the use of the SIN.*

## Investigations of Fraud and Abuse Related to the SIN

**Minimal effort is dedicated to SIN investigations**

**16.60** The previously noted weaknesses make the SIN vulnerable to abuse. Section 141(1) of the *Employment Insurance Act* makes it an offense to:

- knowingly apply for more than one SIN;
- use someone else's number to deceive or defraud;
- loan or sell a SIN or a SIN card to deceive or defraud Employment Insurance; and
- manufacture or duplicate a SIN card.

Identity theft — the illegal use of a person's identity information, including the SIN — is a growing phenomenon in North America.

**16.61** It is worth noting that this section of the *Employment Insurance Act* goes beyond the Employment Insurance program itself and covers illegal use of the SIN to defraud other programs (such as revenue collection, social assistance, etc.), other individuals or companies. It is also an offense under section 102 of the *Canada Pension Plan Act* to knowingly furnish any false or misleading information in applying for a SIN.

**16.62** Since HRDC is responsible for controlling the SIN, it is vital that it conduct proactive and effective investigations in order to prevent, detect and deter abuses that could potentially cost taxpayers many millions of dollars and cause hardship.

**16.63** Identity theft — the illegal use of a person's identity information, including the SIN — is a growing phenomenon in North America. For instance, an American government agency's investigations of financial crimes involving identity fraud estimated that actual losses to the victimized individuals and institutions totalled US$745 million in fiscal year 1997. Other costs of identity theft can also be very high, though not easily quantifiable. Individual victims can suffer injury to their reputation and must undergo the process of clearing their credit rating. In the interim, these individuals may be unable to keep or find a job, obtain a home mortgage or secure a loan.

**16.64** The Investigation and Control Directorate of the Employment Insurance Program is responsible for investigating suspected attempts to defraud the Program. Abuse of the SIN is only one of the forms of fraud this Directorate investigates. In 1996–97, it conducted 958,000 investigations that resulted in total savings of $564 million. However, the savings from investigations that HRDC specifically attributed to the abuse of the SIN represent only a minute fraction of that amount. SIN-related savings for programs other than Employment Insurance are not included and SIN investigations are not always classified as SIN-related. Moreover, the already small number of investigations continues to decline. As shown in Exhibit 16.7, there were 2,730 investigations of SIN abuse in 1997–98, a decline of 52 percent from 1993–94.

**16.65** The Income Security Programs Branch conducted even fewer SIN-related investigations than the Employment Insurance investigators. Given the generally recognized higher risk of fraud represented by mail-in applications (explained in paragraph 16.50), certain income security programs may be very

vulnerable to fraud. Indeed, a pilot project jointly conducted by the Investigation and Control Directorate and the Income Security Programs Branch shows that there is considerable room for a more proactive approach to detecting these frauds.

**SIN investigations could provide substantial results**

**16.66** There are many types of SIN abuses that lead to investigations. SIN abuses are reported by Revenue Canada, Employment Insurance, Canada Pension Plan, Old Age Security and by provinces. Others are reported by financial institutions (banks, credit bureaus), major retail stores and public utilities. In one province, we noted a higher proportion of cases connected to abuse of provincial social services. Many abuses involve someone using a legitimate SIN of another individual to work or to pay less income tax. The legitimate taxpayer may subsequently be reassessed and asked to pay the taxes on this impostor's undeclared income. In such cases, the legitimate taxpayer is advised to contact HRDC and request an investigation. We estimate that income-tax-related investigations represent 17 percent of the SIN investigation workload. As a result of those investigations, in the last five years Revenue Canada has made 1,132 corrections to tax records that represent income totalling $36 million.

**16.67** Some investigations have produced impressive results that demonstrate the significance and potentially high materiality of SIN-related fraud. Such investigations often involve a large number of stolen, invalid or fraudulently obtained SINs and frequently represent large sums of money for the government and individuals. Exhibit 16.8 summarizes some of these investigations, reported to us by departments. It includes investigations conducted by Revenue Canada that also illustrate the potential for recovering funds through investigation of SIN frauds.

Some investigations have produced impressive results that demonstrate the significance and potentially high materiality of SIN-related fraud.

**16.68** Our field visits to some provincial departments demonstrated that abuse and fraud using multiple identities is also present and can be detected. Some of these organizations have special investigation activities to address issues of abuse and fraud. Results clearly demonstrate that theft of identity occurs.

**The quality of SIN investigations needs to be improved**

**16.69** Our review of investigation files revealed several weaknesses in the quality of the investigations conducted. For instance, we estimate that fewer than one percent of investigations ultimately generate a strong enough case to lay

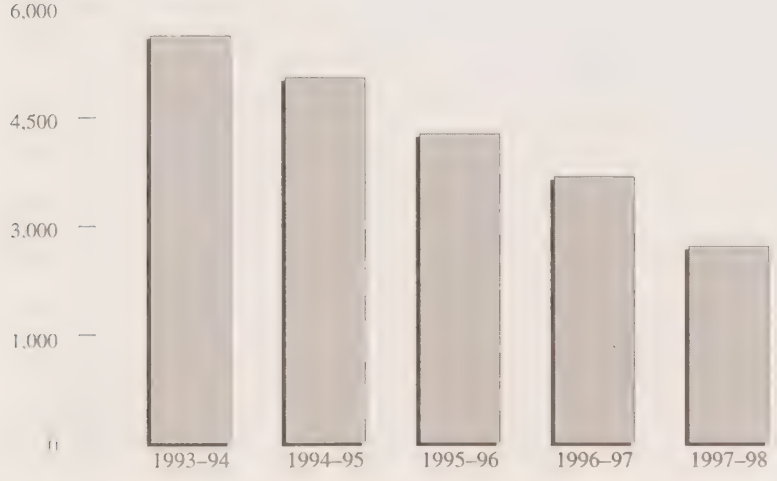



Exhibit 16.7

**Social Insurance Number Investigations Completed by HRDC, 1993–94 to 1997–98**

**Source:** HRDC, Investigation and Control Directorate of the Employment Insurance Program

charges. In one region, investigators were instructed to stop SIN investigations related to income tax at the point where the hardships caused to the legitimate taxpayers had been contained, and to make only limited efforts to identify the perpetrators. We also noted little effort to identify root causes in investigation reports. Only five percent of the investigation files we reviewed contained references to lessons learned and possible corrective action to prevent a recurrence of the activities.

### Existing performance indicators discourage SIN investigations

**16.70** Since 1992, HRDC has implemented a results-based approach to its investigations. They are now assessed using a performance indicator that focusses on total savings generated by investigations. It is based on the dollar value of overpayments, penalties and prosecutions and the value of prevented mispayments. The Treasury Board Secretariat has accepted the indicator as a reasonable and realistic measure of investigative performance and it is now used to determine resource allocations.

**16.71** However, because of the pervasive use of the SIN, this type of fraud also affects other federal departments, provincial, territorial and municipal social services and the private sector. As shown in Exhibit 16.2, Employment Insurance frauds represent only one of many ways the SIN can be used to commit frauds of various kinds. The savings to other programs that are generated through SIN investigations are not attributed by HRDC to Employment Insurance investigators. The Department told us that it had not yet put forward a business case to the Treasury Board for changing the indicators to reflect savings to other programs. Furthermore, when a SIN investigation has a high dollar value

Exhibit 16.8

**Examples of Fraud Investigation Cases Related to the Social Insurance Number**

**Human Resources Development Canada (HRDC)**

- Three individuals who had applied and received 20 false SINs went to a local dealership to lease 18 luxury vehicles purportedly for the new business they were starting. Once they had taken possession of the vehicles they transported them to another city where they were loaded into containers on a freighter going overseas. By the time the police caught up with them, 15 vehicles had been unloaded in another country and only three were seized. The three main suspects had fled to another country. The total value of the fraud perpetrated was $1.1 million.
- An individual currently under investigation by HRDC succeeded in obtaining 30 false SINs, which he used to file 25 Employment Insurance applications. The potential loss to the Department could be in the neighbourhood of $450,000.
- A placement agency provided work to welfare recipients. The agency also provided invalid SINs to those individuals so that they could work while collecting social assistance benefits. This involved 1,295 invalid SINs over a period of seven years, resulting in estimated annual losses of up to $10 million dollars to the social assistance department in the province.

**Revenue Canada**

- An individual entered a major retail food company's warehouse and obtained a number of SINs from employees' time cards. These SINs were used to register 27 fictitious companies, which filed Goods and Services Tax (GST) net tax refund returns totalling approximately $254,000.
- An individual used the SINs of six persons to register 22 fictitious companies and filed 133 GST returns declaring fictitious purchases in the amount of $680 million. He attempted to obtain GST refunds for an aggregate amount of $12,440,918.
- An individual used phony help-wanted ads to obtain personal information about people, including SIN numbers, and then used this information to generate fictitious income tax returns for which Revenue Canada issued tax refunds. Using the SINs of 86 persons, the individual managed to fraudulently obtain $239,000.

**Source:** HRDC and Revenue Canada

or involves a complex scam, the Department often codes it as major fraud or a "third-party denunciation" and the savings generated are not credited to SIN investigations. The end result of the performance measurement model currently used by the Department is that Employment Insurance investigators give SIN investigations very low priority. This, more than anything else, explains the steady decline in the number of SIN investigations and the unsatisfactory quality of those that are conducted.

**16.72** The decline in the number and quality of SIN investigations can also affect the integrity of the SIN data base. A proactive and effective investigation function is necessary to minimize fraudulent activities. Major weaknesses in the system that come to light through investigations need to be recognized and corrected to prevent their recurrence.

**16.73 Human Resources Development Canada should redesign its performance indicators for investigations of abuse of the Social Insurance Number to recognize their importance to not only the Employment Insurance program but also other federal, provincial, territorial and municipal programs.**

***Human Resources Development Canada's response:*** *Agreed. HRDC recognizes the importance of detecting and preventing fraudulent use of the SIN. The value of SIN investigations needs to be defined, particularly in relation to the additional resources required to devote to this increased activity. HRDC will review its performance indicators accordingly.*

**Penalties resulting from successful SIN investigations are minimal**

**16.74** The *Employment Insurance Act* states that the penalty for committing any offenses related to the SIN is a fine of up to $1,000 and/or imprisonment for up to one year. Charges under the Criminal Code can also be pressed. As we have noted, however, very few perpetrators are caught, and even then the Department rarely brings criminal charges. In the files we reviewed, the only case in which charges were laid ended in a fine of $200.

**16.75** Such low fines do not appear to warrant the considerable time and effort that prosecution entails, and their deterrent effect is doubtful. Thus, there is effectively no penalty for activities that could cause considerable damage to social programs, tax collection, commercial activities and the privacy and security of individual Canadians. Administrative penalties such as those applied in cases of Employment Insurance abuse would provide more flexibility, be less costly to administer, deter potential abusers and better protect Canadians from illegal use of the SIN.

**16.76 Human Resources Development Canada should explore the possibility of applying administrative penalties for offences related to the use of Social Insurance Numbers.**

***Human Resources Development Canada's response:*** *HRDC agrees to explore the application of administrative penalties in cases involving fraudulent use of the SIN. This will take into account the requirements for change in the Employment Insurance legislation and the legal and administrative issues associated with implementing and enforcing the legislation, including recovery mechanisms.*

## Impacts on Other Users

**Use of SIN as a de facto national identifier has caused numerous problems for other users**

**16.77** Finding misuse and abuse in any system can be compared to "looking for a needle in a haystack". The way the SIN is managed or not managed has repercussions throughout the income security and revenue collection systems. While the visible impact on any one program may be minimal, the collective impact can be significant. Examples we

The decline in the number and quality of SIN investigations can also affect the integrity of the Social Insurance Number data base.

encountered during our work illustrate this.

There is effectively no penalty for activities that could cause considerable damage to social programs, tax collection, commercial activities and the privacy and security of individual Canadians.

**16.78** Revenue Canada relies on the master file provided by SIR to validate the identity of new tax filers. In the event that identity cannot be validated by SIR, Revenue Canada told us it requests identification documentation from the individual. Revenue Canada also has internal controls that can compensate for errors and catch them after the fact. However, they still leave Revenue Canada vulnerable to inaccurate information found on the SIR data bases due to, among other things, SIN applications that are fraudulent from the outset.

**16.79** In the last few years, a range of cases detected by Revenue Canada investigations revealed a variety of SIN frauds that involved benefit programs of several other departments, both provincial and federal. These fraud cases allowed the perpetrators to fraudulently gain millions of dollars in benefits. Among the many factors that made these frauds possible was the inability to readily verify birth and death data. In some cases, SIN numbers had been stolen from company files.

Provinces, who are among the main users, do not yet have official access to the SIR although HRDC states that it is now possible.

**16.80** As discussed in paragraphs 16.44 and 16.45, the lack of an expiry date on temporary SINs causes problems for Citizenship and Immigration Canada and Revenue Canada and allows abuse and misuse.

**16.81** In the tax year 1993, Revenue Canada received 73,000 tax returns on which the SINs could not be linked to identified taxpayers. It has managed to reduce this number substantially. However, in 1994 (the last year for which Revenue Canada could readily provide up-to-date information on this matter) it still had about 47,000 taxpayers on its books who did not match with the SIR and who represented more than $72 million in income.

**16.82** The provinces do ask that applicants for benefits provide a SIN. However, an applicant can refuse to do so and still receive benefits. The *Income Tax Act* and Regulations require that every province that pays social assistance and workers' compensation to an individual obtain that individual's SIN for use on the T5007 slip, which reports these payments. Although the rate of provincial compliance with that requirement is relatively high, according to Revenue Canada (96 percent of applicants provide SINs), the 110,000 SINs representing the remaining 4 percent translate into $500 million in social assistance and workers' compensation payments for tax year 1996. The slips without a SIN have only a name and an address. There is no birth date, so matching is very difficult.

**16.83** Provinces, who are among the main users, do not yet have official access to the SIR although HRDC states, based on advice from the Department of Justice, that it is now possible. They do not receive information on the five million SIN flags in the system (deceased, fraudulent, cancelled, etc.); this causes problems for the integrity of their data bases. A test by HRDC comparing data in the SIR with provincial data for two medium-sized cities and one province showed inaccuracies in both the SIR and the related data for up to 10 percent of the social assistance population. We noted that where the agency using the SIN has no way of verifying its legitimacy, a knowledgeable applicant can create a number that will work in the system. The financial institutions — who are required by law to collect the SIN for income-related transactions — are likely to face the same problems.

**16.84** HRDC has been working within the existing legal framework of the *Employment Insurance Act* to try to provide access to the SIR for users other than those officially authorized, especially the provinces (see paragraph 16.103 for further explanation). We noted that the

provinces have their own privacy legislation that regulates their governments' use of personal information.

## Legal and Policy Framework for Managing the SIN

**Privacy of information is a key dimension of managing the SIN**

**16.85** Privacy issues revolve around the rights of individuals to exercise control over their personal information. We have thus far dealt with issues related more to the reliability and integrity of the SIN. It is important to make a distinction between security and privacy; a perfectly secure and fraud-proof system could nonetheless be highly intrusive.

**16.86** The right to information privacy can be defined as the right of individuals to determine when, how and to what extent they will share personal information about themselves with others. This generally implies that personal information will be used only for the primary purpose intended and with the consent of the individual where not provided for by law. The individual has the right to review the information for accuracy.

**16.87** The goals of administrative efficiency and service delivery must be balanced against the often competing objective of maintaining individual privacy. The history of the SIN has reflected this tension.

**16.88** The use or abuse of the SIN in violation of privacy has been a concern among Canadians, in particular the fear that it will be used as a universal identifier to create a national data base. Over the years, several hundred inquiries and complaints received by the Office of the Privacy Commissioner have been related to the inappropriate use or disclosure of SIN-related information.

**Extensive use of personal information by HRDC attracts attention of privacy advocates and the Privacy Commissioner**

**16.89** Apart from being the custodian of the SIR, HRDC is one of the most important federal departments involved in the collection and use of personal information. It also has large internal data banks on nearly all Canadians that link personal information and are used for management of programs, evaluation and research.

**16.90** HRDC has over 250 agreements with many partners that deal with the receipt or exchange of personal information. These agreements are reached pursuant to a specific provision in HRDC's or the other partners' legislation that authorizes such exchanges of information. At the end of 1997, HRDC classified 20 such exchanges as data matches, 13 of which were with Revenue Canada.

**16.91** HRDC has a structure in place for administering the *Privacy Act* and the Treasury Board policy on data matching and control of the SIN. There are privacy co-ordinators in each regional office. HRDC officials informed us that all their data-sharing agreements are reviewed by their in-house legal counsel to ensure compliance with the *Privacy Act*. Our review of information obtained from the Privacy Commissioner revealed that of the 36 notifications of proposed new data matches received since 1989, 50 percent came from HRDC. We noted that there is ongoing dialogue between HRDC and the Privacy Commissioner on privacy issues.

**16.92** The Office of the Privacy Commissioner, an independent oversight agency reporting directly to Parliament, recently completed a study for the purpose of examining HRDC's formal strategies for the collection, retention, use and disclosure of personal information. The study was not a compliance review under section 37 of the *Privacy Act*; although it

The use or abuse of the SIN in violation of privacy has been a concern among Canadians, in particular the fear that it will be used as a universal identifier to create a national data base.

Exhibit 16.9

Legislative and Policy Framework Governing Data Matching

**A Parliamentary Committee Report Calls for Improvements in the Canadian Privacy Framework**

A recent parliamentary committee report (April 1997) entitled "Privacy: Where do we draw the line?" outlined a number of areas needing improvement in the Canadian privacy framework and made several recommendations. This report was produced by the House of Commons Standing Committee on Human Rights and the Status of Persons with Disabilities.

The report stated that there is no comprehensive national system of data protection in Canada. It called for comprehensive data protection legislation that would include, among other things, strict protections against unnecessary data matching and standards for acceptable data-matching practices. In particular, the committee's report stated that the current *Privacy Act* provides for little specific control of data matching.

**The Data Matching Policy Is Issued by Treasury Board**

Data matching is the comparing or linking of personal information obtained from different sources for the purpose of making decisions that could affect the individuals to whom the information pertains. It usually involves the exchange of personal information between government institutions or programs, and this exchange must be in accordance with the use and disclosure provisions as well as the other relevant sections of the *Privacy Act*.

As currently defined, an exchange of information is not necessarily a data match if the purpose is not to make decisions affecting individuals. For example, an exchange of information for research purposes is not considered a data match, as no decisions are made about individuals. The concept of data matching and the related role of the Privacy Commissioner are not specifically defined in the *Privacy Act*. However, there is a data matching policy issued pursuant to the authority of the President of the Treasury Board as the "designated Minister" under section 71 of the *Privacy Act*. The "head" of a government institution is responsible for ensuring that the institution complies with the legislation and associated policy and, ultimately, for rendering decisions related to matching activities.

The policy on data matching requires federal agencies to submit proposals for matching to the Privacy Commissioner 60 days in advance. He then reviews or assesses the match against a set of criteria (including compliance with relevant sections of the *Privacy Act*) and acts as an advocate for the subjects of the files. He does not have the power to halt any data-matching proposal. However, he can make recommendations to a department or report to Parliament if he believes that the proposal violates the guideline or the principles of the Act.

**Responsibilities and Controls Over Data Matching Need to Be Reviewed**

Since the introduction of the Treasury Board policy on data matching in 1989, the Privacy Commissioner has received for review 36 notifications of proposed new data matches for about 150 government institutions. In the past, the Privacy Commissioner has raised concerns about whether all data-matching activities of federal government institutions (as well as the related "consistent uses" of personal information) were reported to his Office for review. Our interviews with staff of the Privacy Commissioner and our review of their surveys revealed that concerns still exist.

We noted that the policy does not precisely indicate if the Privacy Commissioner should investigate any unreported data matching by government institutions. The Privacy Commissioner informed us that his Office has not carried out any specific audit of data matching in the past. However, any data-matching activities that had not been reported by government institutions to his Office for review but that came to the staff's attention in the course of their compliance review would be addressed accordingly. There could be a significant gap in the oversight of data matching.

We noted in the policy that the same rules apply equally to all forms of data matching, such as matching on a personal or aggregate level, internal or external matching, up-front or ex post facto matching, etc. The cost/benefit and reporting requirements of the policy are the same regardless of the privacy risks (the potential negative consequences for the individual) inherent in each form of data matching. It is unclear how the data-matching policy applies to federal/provincial/territorial government data matching. Finally, as noted above by the Committee, there are no standards or criteria for acceptable data-matching activities. The 1989 policy does not reflect continuing changes in the technological environment.

*(cont'd)*

Exhibit 16.9

**Legislative and Policy Framework Governing Data Matching**

*(cont'd)*

A related issue is how the principle of consistent use, enshrined in the *Privacy Act*, is put into practice. The *Privacy Act* permits the disclosure of personal information "for the purpose for which the information was obtained or compiled by the institution or for a use consistent with that purpose." The Act does not define the concept of "consistent use", and related guidance provided by the Treasury Board is limited. The purposes for which personal information is obtained are generally defined in broad terms. As a result, a significant amount of sharing of personal information could be justified as consistent. About 1,300 consistent uses are reported in InfoSource, a central index of personal information held by government institutions. The Treasury Board has not defined any standards or criteria for acceptable "consistent use".

Responsibility for developing and reviewing the policy on data matching rests with the Treasury Board, not with the Privacy Commissioner. Treasury Board mainly relies on departments to comply. Overall, there is limited monitoring of the nature and extent of data-matching activities in each federal government institution or whether the SIN is used only by authorized users. The Treasury Board does not monitor whether government institutions have reported all their proposed data matches to the Privacy Commissioner for review. Further, it does not gather comprehensive information about data matching in the federal government with a view to identifying best data-matching practices and lessons learned for sharing with other government institutions.

did contain recommendations, it did not specifically look for unreported data-matching activities.

**16.93** The Privacy Commissioner's study concluded that, overall, HRDC employees demonstrated a good level of privacy awareness. It highlighted areas where the Department was doing well and identified privacy issues to pursue. In particular, the study noted that the Commissioner's Office will be working on a consultative and ongoing basis with HRDC's officials to provide input on such privacy issues as the Common Client Identifier project and access to the Social Insurance Register information. Any issues that the Privacy Commissioner considers significant will be dealt with directly by his Office. We did not seek to duplicate his work.

**16.94** We found that assessing compliance with data-matching policy and guidelines is a contentious area, given the various forms of data matching possible. Current responsibilities and controls over data matching need to be revisited with a view to ensuring adequate protection of personal information (see Exhibit 16.9 for further explanation).

**Unregulated use of SIN in the private sector is a key vulnerability**

**16.95** The use of the SIN is not regulated in the private sector except in Quebec, where private sector use of personal information is regulated by legislation. Unregulated and pervasive use of the SIN in the private sector is seen as a key flaw by privacy advocates because the SIN can be used to violate privacy and to steal identity.

**16.96** Industry Canada and the Department of Justice have started to address the issue of regulating privacy in the federally regulated areas of the private sector. Legislation is expected this fall. However, even if the proposed legislation did address misuse or abuse of the SIN, it would not address the provincially regulated areas of the private sector.

**16.97** Certain areas of the private sector have begun to adopt voluntary privacy codes, generally based on the Canadian Standards Association Model Code for the Protection of Personal Information. In a report released in January 1998, Industry Canada and the Department of Justice said that the current "patchwork" of laws, regulations and privacy codes was not adequate given, among other things, the federal government's increasing exchange

Unregulated and pervasive use of the SIN in the private sector is seen as a key flaw because it could be used to violate privacy and to steal identity.

of personal information with the private sector. Private businesses are more and more involved in the delivery of government services through the contracting out or privatization of some government functions.

**16.98** During our audit we asked various government stakeholders, including the Department of Justice and Industry Canada, to provide us with any studies they had done in the past 15 years on the impact and extent of the use of the SIN in the private sector. No such studies were available. Access to this kind of assessment would be invaluable in determining the potential restrictions of the SIN in the federally regulated private sector, which could then be considered in the upcoming federal privacy legislation.

A revised policy on the new uses of the SIR arising from advice given by the Department of Justice was recently approved by the Employment Insurance Commission.

**16.99 The government should seriously consider conducting an assessment of the impact and extent of private sector use of the Social Insurance Number, and use the upcoming privacy legislation as an opportunity to address long-standing concerns about related privacy issues.**

***Industry Canada's response:*** *Industry Canada has consulted with the Department of Justice in the preparation of this response to the recommendation regarding the use of the SIN by the private sector. We have noted the Auditor General's interest in the use of the SIN by the business community, and share his views that further study of the extent of that use would be valuable. We will be examining ways to obtain more accurate information in this regard, in concert with other interested government departments. We also note the reference to the legislation that Industry Canada and the Department of Justice will be introducing shortly to protect personal information in the private sector. We believe that this legislation will address the issue of unnecessary collection and misuse of personal information, including the SIN, and we will study the recommendation for further specific protection of the SIN in the context of our ongoing work on this legislation.*

**Progress in clarifying the role and improving the management of the SIN is slow**

**16.100** HRDC and other players have made several attempts to improve the management of the SIN. In 1990, the Evaluation section of HRDC issued a report and made a number of recommendations aimed at improving the application process and the reliability of the data base. An Interdepartmental Task Force on the Integrity of the Social Insurance Register was formed in 1994. Its initial mandate was to deal with residency issues related to Goods and Services Tax Credit and Child Tax Benefit payments, the transfer of Revenue Canada's death data to the SIR and the exchange of information on SINs found to have been used for fraudulent purposes. In 1994, staff responsible for the SIR issued a report entitled "Modernization of the SIN: The Key to Social Security Reform".

**16.101** The response to these events, although difficult to attribute to any one of them specifically, was a number of system improvements and new data-sharing activities. They also led to better co-ordination and the use of common guidelines between Revenue Canada and HRDC on handling victims of identity theft and communicating information on false or problem SINs in the system.

**16.102** Phase II of the Interdepartmental Task Force to address more fundamental issues was never undertaken and its activities were suspended sometime in 1995. The reasons for not proceeding further with this specific initiative were never stated officially.

**16.103** As discussed in paragraphs 16.83 and 16.84, HRDC has been working within the existing legal framework of the *Employment Insurance Act* to try to provide access to the SIR for users other than those officially authorized, especially

the provinces. A revised policy on the new uses of the SIR arising from advice given by the Department of Justice was recently approved by the Employment Insurance Commission. This policy states that SIR information can be shared with federal, provincial, territorial and municipal government agencies involved in providing financial assistance, whether in the form of welfare assistance, training benefits or grants or workers' compensation payments. HRDC told us it plans to facilitate access through written agreements with the provinces, similar to the labour market agreement process.

**16.104** We note that the revised policy approved by the Commission, which grants greater access to the SIR, supports its continued use by other jurisdictions. This seems to be inconsistent with the Treasury Board policy aimed at preventing expanded use of the SIN. The Office of the Privacy Commissioner states that it is working closely with HRDC officials to provide input on the privacy issues related to expanded access to the SIR.

**16.105** In 1996, HRDC and provincial and territorial social service departments began an initiative aimed at delivering social services more efficiently and effectively through the use of a common client identifier (CCI). The core options considered, apart from the status quo, for use as a CCI by the Federal/Provincial/Territorial Working Group were the following:

- use of the current SIN for all federal/provincial/territorial income security clients, with the current configuration and administration of the SIN;
- modernization of the SIN with digitized personal and security information, linking the card to the holder; and
- establishment of a new client identifier to replace the SIN.

While the research raised a number of key issues associated with each, it appeared to favour using the SIN, even with its apparent weaknesses.

**16.106** It quickly became evident that this initiative would need considerable support to overcome the political sensitivities associated with privacy issues. In July 1997, HRDC wrote officially to the Treasury Board stressing the need for a government-wide privacy framework, particularly given the growing momentum toward use of a common client identifier.

**16.107** At the time of our audit, HRDC had not completed the subsequent business case for the Common Client Identifier project, so we are not able to comment on its conclusions.

**16.108** A recent research study (January 1998) done on behalf of HRDC and the Federal/Provincial/Territorial Working Group on Common Client Identifiers examined the experiences and lessons learned in the introduction and use of a CCI in seven other jurisdictions. All of the jurisdictions studied have considered or are now implementing a CCI. In a few of these countries, identification numbers have proliferated in much the same way as in Canada. Exhibit 16.10 highlights some of the experiences and lessons learned. The study concluded that using an existing number with which the public is comfortable has found better acceptance; successful experiences with a CCI have used an existing number rather than introducing a new identifier. Smaller-scale application of a CCI, aimed at specific clusters of programs such as income security programs and using an existing identification number, was one approach used by other jurisdictions.

**16.109** The effectiveness of certain administrative decisions as well as the integrity of social programs are greatly facilitated by the reliability of the information contained in the SIN data base. We believe it is time to review the current roles, objectives and uses of the

The effectiveness of certain administrative decisions as well as the integrity of social programs are greatly facilitated by the reliability of the information contained in the SIN data base.

SIN in light of its governmental and societal importance. The government needs to clearly state the level of integrity and privacy protection expected in the system.

**16.110** There appear to be two options: improve the existing framework to catch up with the current reality of SIN usage or else devise an acceptable alternative solution to meet the needs of users, including governments and individuals. In any case, the privacy implications need to be recognized.

## Conclusion

**16.111** Our audit objective was to determine whether the management and control of the SIN is efficient and effective and has an appropriate basis in the legislation. Our audit findings highlighted the numerous problems associated with the use of the SIN as well as its inherent unreliability. There is a critical gap between the framework for the SIN and the role it now plays in Canadian society. The SIN was originally conceived as a file numbering system to identify individuals collecting Unemployment Insurance and CPP benefits, not as a means to accurately identify individuals across the national income security and tax collection systems. Given the pervasiveness of the SIN, the proof-of-identity procedures are flawed, the information in the SIN data base is not always complete and accurate, there is

Exhibit 16.10

**Some International Experiences and Lessons Learned from the Introduction and Use of a Common Client Identifier in 7 International Jurisdictions**

**International jurisdictions**

- Australia, Belgium, France, Ireland, United Kingdom, United States and California

**Balancing competing objectives**

- All of the jurisdictions examined had to deal with balancing the often competing objectives of maintaining individual privacy and confidentiality and improving administrative efficiency and effectiveness.

**Data matching**

- The main impetus for using a Common Client Identifier (CCI) was the need to facilitate accurate and timely data matching. The CCI is the key to accurate data matching and better verification of identity.
- In general, jurisdictions stated that accurate data matching led to improved service delivery and administrative efficiencies, and reduced levels of fraud and abuse. One jurisdiction's additional reasons for using a CCI were better integration of social services and simplification of systems and procedures.

**Data protection**

- The introduction of a CCI sparked a debate about data protection in the jurisdictions. In some jurisdictions, the debate culminated in the adoption of new data protection legislation. In others, the debate led to a decision not to use a national identifier.

**Legislative framework**

- Legislation required significant revisions to provide a workable framework for data matching. Countries had to deal with the following issues when revising or developing legislation: the circumstances under which data matching would be considered lawful; protocols to curtail and control inappropriate matching; how information would be obtained fairly; parameters for use and disclosure of information; and effective security measures to safeguard personal information.
- In certain jurisdictions, the introduction of a wide-scale national CCI was abandoned because the public was not confident that the government's legislation would protect the citizenry from an encroachment on personal privacy.

**Source:** Internal Study done on behalf of HRDC and the Federal/Provincial/Territorial Working Group; January 1998 (not audited).

minimal protection for individuals whose numbers are misused, and the penalties for misuse are weak and difficult to apply. As well, there is little privacy protection for owners of a SIN, particularly in the private sector. These fundamental issues remain unresolved.

**16.112** We have determined that major improvements are possible and need to be made. We noted that initiatives to achieve such improvements have been hampered by perceived political sensitivities over impacts on privacy and by a lack of leadership.

**16.113** The implications of legitimizing the use of the SIN as a common client identifier for income security and revenue collection programs in Canada need to be fully debated and compared with alternatives.

**16.114** In our view, it is essential that Parliament play a major role in debating these issues, increasing public awareness and finding a satisfactory solution.

***Joint comments of Human Resources Development Canada, Department of Justice and Treasury Board Secretariat:*** *The federal government remains strongly committed to the principles governing the protection of privacy. The Treasury Board Secretariat, Department of Justice and Human Resources Development Canada work together in their respective roles and responsibilities regarding the SIN. HRDC is dedicated to diligent stewardship of the SIN and is in general agreement with the observations and findings arising out of the audit concerning its responsibilities related to the issuance of social insurance numbers, maintenance of the Social Insurance Register, and investigation of suspected abuse. The recommendations will provide additional support to work already under way in many of these areas with other federal government departments and provincial and territorial partners.*

*In this chapter, the Auditor General has noted the expanded use of the SIN and access to the SIR by governments for operational effectiveness and efficiency purposes. The use of the SIN within the federal domain is regulated by specific legislation. As the chapter indicates, HRDC's administration of the SIN is in accordance with the intent of its legal framework whereby the SIN is intended to be a file identifier (account number) for certain federal government programs.*

*As the chapter also notes, the provinces have their own privacy legislation that regulates their governments' use of personal information.*

*The Auditor General is concerned with private sector use of the SIN and the perception this may create that the SIN is becoming a national identity number. The chapter also refers to the fact that the government will be introducing legislation in the near future to protect personal information in the private sector. We believe that this legislation will address the issue of unnecessary collection and misuse of personal information, including the SIN.*

*Should there be any future changes to the legislative framework authorizing new or different uses of the SIN, Treasury Board Secretariat, Department of Justice and HRDC will work with interested stakeholders to ensure that associated policies are revised and that they meet operational requirements.*

It is essential that Parliament play a major role in debating these issues, increasing public awareness and finding a satisfactory solution.



# About the Audit

## Objectives

The objective of our audit was to assess the management and control of the SIN to determine if it is efficient and effective and has an appropriate basis in legislation. More specifically, we sought to:

- examine the role and uses of the SIN;
- examine and assess the SIN application process and the management of the Social Insurance Register;
- assess the investigations of fraud and abuse related to the SIN; and
- assess its basis in legislation.

## Scope

Our audit covered:

- the role and use of the SIN in the management of various Canadian social programs;
- the application process and management of the Social Insurance Register;
- the proof-of-identity program for the SIN;
- the investigations of fraud and abuse related to the SIN;
- the efforts made to improve the SIN; and
- the legislation, policies and guidelines related to the SIN.

We interviewed officials and reviewed documentation at HRDC headquarters and in other federal departments and agencies who are users of the SIN (Revenue Canada and Citizenship and Immigration Canada), those who have responsibilities with respect to the SIN (Treasury Board Secretariat, Department of Justice and Office of the Privacy Commissioner) and those who have relevant experience (Royal Canadian Mounted Police, Industry Canada, Passport Office and Elections Canada). We also interviewed officials in three provinces whose departments and agencies are users or stakeholders of the SIN (such as social services, workers' compensation boards, health services, motor vehicle bureaus, etc.). We visited nine Human Resource Centres of Canada in Ontario, Quebec, Alberta and British Columbia and the Social Insurance Register in Bathurst, New Brunswick. We analyzed planning documents, minutes of meetings, internal studies, performance reports and other related documents.

## Criteria

- The SIN application process should be controlled in order to prevent, at a reasonable cost, the issuance of SINs to individuals who are making fraudulent applications.
- The SIN central register should be managed in a way that ensures the reliability, integrity and confidentiality of personal data; its operations should be managed in an efficient and effective manner.
- The use of the SIN and the SIN card in government programs should be well controlled to reduce abuse, fraud and inappropriate access to the personal data.

- Investigations should detect and prosecute instances of fraud and abuse in a timely, cost-effective manner. The sanctions imposed should have a deterrent effect.
- The SIN should be a reliable tool to control social programs.

## Quantitative Information

The quantitative information in this chapter has been drawn from various sources indicated in the text. Unless otherwise indicated, the information has been examined for reasonableness but not audited.

## Audit Team

Assistant Auditor General: David Rattray
Principal: Theresa Duk
Directors: Maurice Laplante and Gaëtan Poitras

Martin Dompierre
Yves Genest
Marc Larose
Yvon Roy

For information, please contact Theresa Duk or David Rattray.

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# Report of the Auditor General of Canada to the House of Commons

## Chapter 17
Patented Medicine Prices Review Board

**September 1998**

# Report of the Auditor General of Canada to the House of Commons

## Chapter 17
Patented Medicine Prices Review Board



# September 1998

*This September 1998 Report comprises 9 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.*

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# Chapter 17

## Patented Medicine Prices Review Board

*The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.*

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# Patented Medicine Prices Review Board

## Main Points

**17.1** The Patented Medicine Prices Review Board (PMPRB) is a small quasi-judicial board with an annual budget of approximately $3 million and 35 full-time-equivalent employees. Created in 1987, it has a mandate to protect consumer interests and contribute to Canadian health care by ensuring that prices charged by manufacturers of patented medicines are not excessive. However, the scope of its jurisdiction and the limitations of its consumer protection role are not widely understood.

**17.2** Since 1988, average annual increases in prices of patented medicines have moderated. The Board has contributed to the containment of patented drug prices, and has taken steps to assess the impact of federal price regulation. However, other factors also have contributed and we are concerned that the Board's estimates of its savings to the Canadian health care system are overstated. In reporting its results to Parliament, the Board did not clearly identify the limitations of the estimates of its own impact.

**17.3** The audit identified issues pertaining to the legislative framework that need to be reviewed. The legislation is silent or unclear on certain areas. In addition, some requirements under the legislation are difficult to apply in practice, and consideration needs to be given to reviewing their continued relevance.

**17.4** The majority of patented drugs sold in Canada are priced within the Board's guidelines. However, the Board needs to ensure that its price review decisions are clear and transparent. The Board also needs to identify cost-effective means to check the accuracy of price information submitted by manufacturers. Improvements are also required in the reporting of drug price trends and pharmaceutical research and development expenditures.

## Introduction

**17.5** The Patented Medicine Prices Review Board (PMPRB) was created by Parliament in December 1987 under the *Patent Act*. It has a mandate to protect consumer interests and contribute to Canadian health care by ensuring that prices charged by manufacturers of patented medicines are not excessive.

**17.6** The PMPRB is a quasi-judicial body whose main activity is regulating the maximum prices charged by manufacturers of patented drugs sold in Canada. The Board also reports to Parliament through the Minister of Health on its activities, on trends in all drug prices, and on research and development spending by pharmaceutical patentees.

**17.7** The Board is located in Ottawa and comprises up to five members, including a Chair and a Vice-Chair, appointed by the Governor in Council to serve on a part-time basis. The Chair is designated the Chief Executive Officer, with authority and responsibility to supervise and direct the work of the Board, including the duties of its staff. Reporting to the Chair is the Executive Director, who manages the work of Board staff. In 1997–98, the Board had 35 full-time-equivalent employees, with a budget of approximately $3.1 million.

### Historical context for federal regulation of patented medicines

**17.8** Since 1923, the *Patent Act* has had special provisions relating to patented medicines. The federal government has attempted to balance its desire to achieve lower prices for medicines against the need for a patent system that encourages development of new medicines through providing exclusive rights to manufacture patented drugs.

**17.9** From 1923 to 1969, the Act allowed the Commissioner of Patents to grant a compulsory licence to any manufacturer for the purposes of preparing and selling a medicine in Canada by paying to the patent owner a royalty fee prescribed by legislation. Under this scheme, patent owners did not have exclusive rights to their patented inventions.

**17.10** In 1969, the government introduced changes to increase the use of compulsory licensing whereby manufacturers could also import a patented invention to produce and sell copies of patented medicines, usually in the form of lower-priced generic drugs.

**17.11** In 1987, however, the government brought forward changes to limit the use of compulsory licensing of patented medicines. In return for more patent protection, the brand name pharmaceutical industry made a public commitment to increase its annual research and development spending to 10 percent of sales by the end of 1996. To ensure that pharmaceutical patentees would not charge excessive prices, the government established the PMPRB.

To ensure that pharmaceutical patentees would not charge excessive prices, the government established the Patented Medicine Prices Review Board (PMPRB).

**17.12** In 1993, the legislation was further amended to abolish compulsory licensing of patented medicines altogether and to strengthen the remedial powers of the Board.

### The federal price regulation framework for patented medicines

**17.13** The various amendments to the *Patent Act* and the associated regulations provide a framework for the federal regulation of patented medicine prices. The *Patent Act* falls under the jurisdiction of the Minister of Industry, but sections pertaining to the work of the Board are under the jurisdiction of the Minister of Health.

**17.14** The legislation requires the Board to consider various factors in determining whether a patented medicine is being sold or has been sold in Canada at an excessive price. These factors are described in Exhibit 17.1.

**17.15** The Act empowers the Board to take remedial action when, following a public hearing, it finds that a manufacturer of a patented medicine is charging an excessive price. The legislation also empowers the Board to issue guidelines on matters within its jurisdiction. Further, the legislation requires pharmaceutical patentees to provide information to the Board on the prices of patented medicines they sell in Canada and elsewhere. There are penalty provisions for non-compliance with the requirement.

**17.16** Regulations specify the information and documents that must be provided. They include requirements relating to the prices of each patented medicine sold in Canada and its prices in foreign countries where it is sold.

**17.17** In consultation with stakeholders, including the pharmaceutical industry, consumer groups and ministers of health, the Board has established a compliance and enforcement policy and published guidelines using the factors outlined in the legislation and regulations. These guidelines, which are not binding on the Board or on any patentee, are intended to limit the introductory prices of new patented medicines and the annual price increases of patented drugs already on the market (Exhibit 17.2).

## Current environment for regulation and control of drug prices and costs

**17.18** Globally, the pharmaceutical industry is dominated by large multinational companies. In 1997, worldwide sales of drugs by manufacturers increased by about 8.6 percent over the previous year to more than $400 billion. In the same period, Canadian sales of patented and non-patented drugs by manufacturers increased by approximately 6.0 percent to about $7.0 billion; patented drugs accounted for $3.7 billion of that amount, an increase of some 22.6 percent.

**17.19** In Canada, spending on pharmaceutical drugs has increased faster than on other key elements of health care such as hospitals and physicians. The growing expenditures on drugs have been a concern in Canada and in other countries as well.

**17.20** Increasingly, provincial governments, hospitals and other public and private operators of drug plans in Canada have adopted a variety of measures in an attempt to control their drug costs. For example, provinces have used formularies to limit the drugs eligible for reimbursement and have established ceilings for reimbursement. In 1994, Ontario also implemented a price freeze policy on all drugs listed on its formulary. Hospitals have focussed on improving their practices for dispensing and purchasing drugs.

**17.21** Many industrialized countries, including Canada, have national systems that regulate drug prices or the profits of drug manufacturers in various ways.

Exhibit 17.1

**Price Comparison Factors**

Section 85 of the *Patent Act* specifies the following factors to consider in determining whether prices of patented medicines are excessive:

- the prices at which the medicine has been sold in Canada;
- the prices of other medicines in the same therapeutic class sold in Canada;
- the prices of the medicine and other medicines in the same therapeutic class sold in countries other than Canada (as specified in the Patented Medicines Regulations, they are France, Germany, Italy, Sweden, Switzerland, United Kingdom and the United States);
- changes in the Consumer Price Index; and
- other factors as specified in the regulations.

### Focus of the audit

**17.22** In its April 1997 report, the Standing Committee on Industry recommended that the Office of the Auditor General audit the PMPRB to provide Parliament with information on its performance and efficiency. Following our preliminary work, we decided to proceed with a full value-for-money audit of the Board. We examined the Board's evaluation of the impact of federal regulation on patented drug prices, the implementation of the legislative framework and the way the Board regulates the prices of patented medicines sold in Canada. The audit focussed on the Board's reporting of results, its price review activities, and its reporting of drug price trends and spending on pharmaceutical research and development. We also looked at certain aspects of the Board's administration. Further details on the audit scope, objectives and criteria are presented at the end of the chapter in **About the Audit.**

## Observations and Recommendations

### Impact of Federal Regulation of Patented Drug Prices

#### Average annual increases in prices of patented medicines have moderated

**17.23** From 1982 to 1987, annual price increases of pharmaceutical drugs were proportionally higher than annual increases in the Consumer Price Index (CPI). After 1988, the drug price trends reported by the Board show an overall decline in the annual growth of patented drug prices relative to the CPI.

**17.24** From 1988 to 1997, the average increase in the CPI was approximately 2.8 percent per year, while the Board's Patented Medicine Price Index (PMPI), an index of manufacturers' prices for patented drugs, increased at an average rate of about 1.0 percent per year. The rate of annual change in the PMPI was also

Exhibit 17.2

**Guidelines on Excessive Price of Patented Medicines**

**Existing medicines.** Price increases are limited to changes in the Consumer Price Index (CPI). The excessive price test is based on a three-year cumulative change in the CPI. In addition, single-year increases are limited to 1.5 times the forecast change in the annual index. In periods of high inflation (over 10%), the limit will be five percentage points more than the forecast change in the annual index.

**New medicines.** The guidelines establish three categories for purposes of limiting the introductory prices of new medicines.

- Category 1 - Drugs that represent a new product of an existing or comparable dosage form of an existing medicine: The price will be presumed to be excessive if it does not bear a reasonable relationship to the average price of the same medicine in the same or comparable dosage forms.
- Category 2 - Breakthrough drugs or products that provide substantial improvement over comparable existing products: The price will be presumed to be excessive if it exceeds the higher of the cost of therapy with medicines in the same therapeutic class or the median of prices of the same drug in the seven foreign countries listed in the Patented Medicines Regulations.
- Category 3 - Drugs that provide moderate, little or no improvement over existing drugs: The price will be presumed to be excessive if the cost of therapy with the new drug is higher than the cost of therapy with existing comparable drug products in the same therapeutic class.

In addition, the price of a patented drug cannot exceed the highest price of the same medicine sold in the seven countries listed in the regulations.

**Source:** Patented Medicine Prices Review Board

The Board has exerted a constraining influence on the prices of patented medicines sold in Canada.

Factors other than the Board's activities also need to be taken into account in determining its impact.

lower than the average increase in the pharmaceutical component of the Industrial Product Price Index (an index that includes both patented and non-patented drugs), reported by Statistics Canada at 2.2 percent during the same period (Exhibit 17.3).

**The Board has contributed to containing the prices of patented medicines**

**17.25** Based on our review, it is evident that the Board has exerted a constraining influence on the prices of patented medicines sold in Canada. The decline in the rate of patented medicine price increases relative to the CPI began after 1988 and coincides with the federal regulation of patented drug prices.

**17.26** The overall decline in the rate of annual price increases compared with the CPI is to be expected, because the Board's guidelines stipulate that the price of an existing patented drug product should not increase by more than the CPI. However, the evidence also suggests that factors other than price regulation have exerted a moderating influence on patented drug prices.

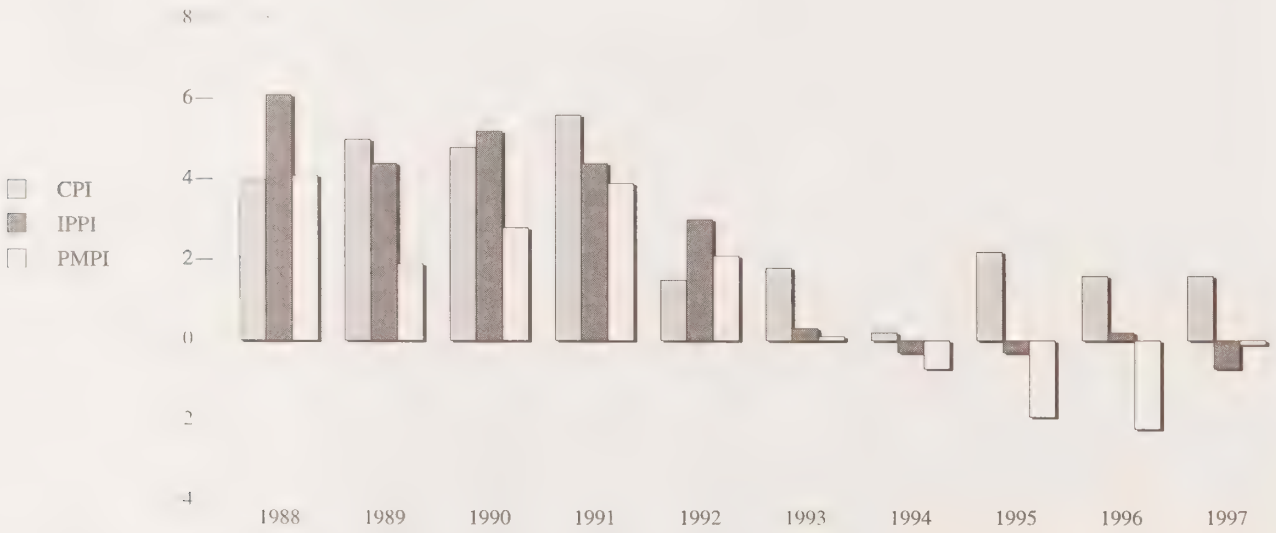
**Other factors have contributed to containing the prices of patented medicines**

**17.27** The Board's data indicate that between 1991 and 1994, on average the prices of more than half of the 200 top-selling patented drug products in Canada either remained constant or fell, while the CPI continued to rise (Exhibit 17.4).

**17.28** It is not clear from currently available information how these pricing patterns would automatically be the consequence solely of the Board's activities. If federal price regulation were the sole factor in price containment, then the prices of patented medicines could be expected to grow to the maximum permitted under the Board's guidelines on

Exhibit 17.3

**Year-over-Year Percentage Changes in Consumer Price Index (CPI), Industrial Product Price Index [pharma] (IPPI) and Patented Medicine Price Index (PMPI), 1988–1997**




**Source:** Statistics Canada (CPI & IPPI) and Patented Medicine Prices Review Board (PMPI)

excessive prices. That they have not done so implies that factors other than the Board's activities also need to be taken into account.

**17.29** A number of provincial governments have taken steps to control their health-related expenditures. As indicated by the Board itself, federal regulation of prices and provincial cost-containment measures have resulted in complementary policies to control drug prices and costs.

**17.30** Another factor that could also have had an effect on the prices of patented medicines is the increased market penetration of patented drug manufacturers as a result of the elimination of compulsory licensing and the extension of the period of market exclusivity. The influence of private health insurance programs is yet another factor.

**The Board needs to improve its measurement of the effectiveness of its activities**

**17.31** In a regulatory program of this type, the budgetary expenditures are quite small compared with those of most federal programs. However, the impact of price regulation in this area is potentially very significant. Price regulation can have an impact on levels of profitability and levels of investment in the pharmaceuticals sector, on the cost of the Canadian health care system and on the welfare of the Canadian public.

**17.32** The Board has taken steps to assess the impact of federal regulation of patented drug prices. In February 1997, it published its study entitled "The Impact of Federal Regulation of Patented Drug Prices". This evaluation examined the impact of federal price regulation of patented drugs in achieving savings to the Canadian health care system.

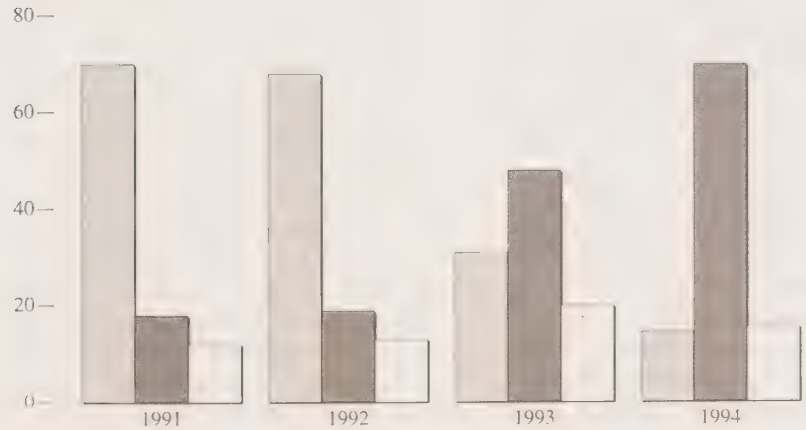
The Board has taken steps to assess the impact of federal regulation of patented drug prices.

**17.33** The Board's study found that from 1988 to 1995, the federal regulation of drug prices resulted in estimated total savings to the Canadian health care system of between $2.9 billion and $4.2 billion. The estimates were derived from assumptions of what prices would have been and how much more would have been spent on patented drugs in Canada in the absence of federal price regulation. The Board indicated to us that as part of its evaluation process, it had submitted its study to external review before finalizing it.

**17.34** We would expect the Board's evaluation to situate its activities clearly in the context of other policy developments influencing the levels of patented drug prices. Further, we would expect the Board to provide a perspective

Exhibit 17.4

**Percentage of Top 200 Patented Drug Products Whose Prices Remained Constant or Fell, 1991–1994**




**Source:** Patented Medicine Prices Review Board

We are concerned that the Board's estimates of its savings to the Canadian health care system are overstated.

on how these other activities would impact on its own results.

**17.35** The Board's study acknowledged that provincial cost-containment measures have resulted in complementary policies to control prices and costs. However, the Board's measurement of savings did not assess the possible effects of provincial measures. Similarly, the Board did not attempt to take into account the possible impact on prices resulting from the discontinuing of the previous system of compulsory licensing. Based on the finding in Exhibit 17.4 that federal price regulation is not the sole constraining influence, along with the Board's own recognition that other factors are involved, we are concerned that the Board's estimates of its savings to the Canadian health care system are overstated.

**17.36** We believe that the Board needs to use better evaluation methods to take these external factors into account when it measures the actual impact of its activities. The Board's evaluation report states that it is difficult to assess what portion of the impact estimated in its study might be attributable to the activities of provincial governments and other purchasers to control their expenditures. However, our audit work identified a possible approach to addressing some such issues, based on a 1992 study undertaken by the United States General Accounting Office. In our judgment, such an approach would be a cost-effective means to assist the Board in improving the measurement of its effectiveness and better informing Parliament of the results achieved.

**17.37** In our view, it is essential that Parliament obtain information to assist in identifying clearly all those program and policy initiatives that affect the achievement of the government's objectives. We urge the Board to improve its measurement of its effectiveness — both for purposes of accountability to Parliament and to assist decision makers in improving the program.

**17.38 The Patented Medicine Prices Review Board should improve its approach to measuring the effectiveness of its activities, taking into account other factors that have an impact on patented drug prices.**

***Board's response:*** *The Board welcomes the Auditor General's encouragement of its efforts to evaluate its impact and it will continue to seek ways of improving the measurement of its effectiveness. It will also continue its recent work to assist in the evaluation of provincial and other policies at the request of the task forces established by the federal/provincial/territorial ministers of health.*

### Reporting of results to Parliament also needs improvement

**17.39** The Board has reported its evaluation findings on its activities to Parliament. The findings were reported as part of the Improved Reporting to Parliament Initiative covering the period ended 31 March 1997, and as part of the Board's submission on 4 March 1997 to the Standing Committee on Industry during the Committee's review of the *Patent Act*.

**17.40** As we have noted, the Board's evaluation report acknowledged the tentative nature of the $2.9 billion to $4.2 billion range of savings as the result of its price regulation activities. However, in reporting this result to Parliament, the Board did not provide a clear perspective on the limitations of its estimates and did not indicate that the effects of other factors should also be considered on the level of savings it specifically attributed to federal price regulation. When it is receiving performance information from departments and agencies on results achieved, Parliament needs to be provided with a realistic perspective on the reliability of the information.

## Legislative Framework

**The Board's role and scope of jurisdiction are not widely understood**

**17.41** The Board receives many complaints from the public about drug prices every year. In many of these cases, the drugs in question are non-patented drugs, outside the jurisdiction of the Board. A perception exists that the Board regulates the prices of all drugs.

**17.42** Although the Board is required to report trends in the prices of all drugs, it is not within its jurisdiction to regulate the prices of generic drugs, drugs that have never been patented, and drugs whose patent has expired. Further, the Board regulates only the price at which the patentee sells the medicine; this is usually the price charged by the manufacturer to a wholesaler or directly to a hospital or pharmacy. In addition to the manufacturer's price, the retail cost of a prescription or over-the-counter drug includes distribution costs, mark-ups and applicable dispensing fees, none of which the Board regulates. Thus, only one of the components making up the price paid by consumers is subject to the Board's regulation.

**17.43** An environmental scan undertaken by the Board in 1995 found a low level of public awareness about its role. Several stakeholder groups suggested that the Board needed to examine its communications strategy.

**17.44** In addition to public consultations, the Board has issued a number of publications and newsletters and has placed information on the Internet to keep interested parties informed of its work. However, it recognizes that many organizations and individuals remain unfamiliar with its role.

**17.45** The lack of general public knowledge about the Board leaves a significant expectation gap between what it actually does and what the public expects that it does to regulate prices of medicines and protect consumers. We encourage the Board to continue to improve its communications and, where possible, to use other vehicles or stakeholders as part of its communications strategy to enhance public awareness of its work.

**17.46** At the time of our audit, the Board had initiated a consultation process with stakeholders to examine its role, functions and methods with a view to increasing its relevance to the needs of those it serves. We are fully supportive of this initiative.

**17.47 The Patented Medicine Prices Review Board should continue to identify opportunities to use other vehicles or stakeholder groups as part of its communications strategy to enhance public awareness of the activities for which it is and is not responsible.**

***Board's response:*** *The Board agrees and is encouraged to note the Auditor General's support of its current initiatives.*

The lack of general public knowledge about the Board leaves a significant expectation gap between what it actually does and what the public expects that it does to regulate prices of medicines and protect consumers.

**Inherent difficulties in the legislative framework**

**17.48** As we have noted, the PMPRB was established through amendments to the *Patent Act*. The Act and the Patented Medicines Regulations together set out the legislative framework for the federal system of price regulation and its administration by the Board. We expected that the Board would take the necessary steps to ensure compliance with the legislation and regulations, and would enforce them. Where the legislative framework posed constraints on its ability to fulfil its mandate, we expected the Board would propose that changes to legislation and regulations be considered.

**17.49** We observed that some requirements in the legislation and regulations are difficult to apply in practice, and a review of their continued relevance needs to be considered. In

Some requirements in the legislation and regulations are difficult to apply in practice.

addition, the legislation is silent or unclear on some issues. This has hindered the Board's ability to fulfil its mandate.

**17.50** **Price factors.** The legislation requires the Board to consider four factors in determining whether a patented medicine is sold in Canada at an excessive price. These factors include the price of the drug in Canada and its price in other countries. However, the factors are not well defined in the legislation or regulations.

**17.51** The regulations specify the information that patentees are required to provide, with different requirements for Canadian prices and foreign prices. For sales in Canada, this includes the publicly available ex-factory price as well as the average price per package of the medicine to each class of customer (wholesalers, hospitals and pharmacies) net of discounts, rebates and free goods, or total net revenues for all package sizes of the medicine. For foreign prices, the regulations require only the publicly available ex-factory price to each class of customer in seven specified foreign countries.

**17.52** In applying its guidelines to determine excessive prices, the Board compares net average transaction prices in Canada with average foreign ex-factory prices, which are not necessarily net of discounts, rebates and free goods. In effect, the Board has interpreted the Act and the regulations to call for comparison of prices that are composed differently.

**17.53** In addition, the regulations require the patentee to certify that the information it provides is true and correct. In practice, however, it is difficult to check drug prices in foreign countries. The publicly available foreign ex-factory prices reported by patentees are often not found directly in public reference sources, such as price lists published by foreign governments or pharmaceutical associations. This is discussed further in paragraphs 17.83 to 17.89.

**17.54** The legislation also requires the Board to consider the foreign prices of other drugs in the same therapeutic class. However, the Board indicated that it is not practical to address this factor in its guidelines because of the inherent differences in the uses, availability and prices of drugs in foreign countries. As a result, the Board staff feel that it is not possible to meet this requirement of the Act in its initial assessments. However, the Board believes that on the occasions where such a comparison has been required for a hearing, it has been able to meet this requirement.

**17.55** **Foreign countries.** The regulations list seven foreign countries for comparative price information: France, Germany, Italy, Sweden, Switzerland, United Kingdom and the United States. The six European countries have national systems to regulate drug prices or profits that are quite different from Canada's; the United States has no regulatory system that affects the pricing of pharmaceuticals.

**17.56** The "basket" of seven foreign countries poses a practical constraint on comparing international drug prices. We found that often it is not possible to make a meaningful comparison between the Canadian price of a patented drug and its prices in the seven foreign countries. Our analysis of the Board's data showed that in approximately 20 percent of the cases, the only foreign country selling the same drug was the United States, which has the highest drug prices overall.

**17.57** **Patent dedication.** Between 1989 and 1995, pharmaceutical patentees notified the Commissioner of Patents of more than 130 drug products for which they had surrendered their patent rights and entitlements, in order that other manufacturers could benefit from their use before the term of the patent expired.

**17.58** The *Patent Act* is silent on this "dedication" of patents and on the

Board's jurisdiction over products whose patents are dedicated for public use. However, as stated in its 1991 annual report, the Board took the position that drug products with patents dedicated for public use would cease to be subject to its review.

**17.59** Subsequently, the Board realized that patent dedication had become a serious problem. It was concerned that patentees may have used this practice to avoid having the product subject to the Board's price review. The Board's analysis revealed that at least 43 of these products were priced above its guidelines, resulting in a cost to Canadians of nearly $40 million in the period from 1 January 1989 to 1 July 1995.

**17.60** In October 1995, having obtained legal advice, the Board changed its practice to assert jurisdiction over drug products whose patents have been dedicated, believing that an argument could be made that these products do fall within the Board's jurisdiction. The Board believes that the new policy is based on a correct interpretation of the Act, and says that it is confident this policy will be upheld in the courts should it be challenged.

**17.61** In a 1996 ruling on one case, the Federal Court of Appeal noted, "That the Act makes no express provision for the possibility of patent dedication is at least one other complication that will have to be dealt with at some future date." As the Act remains silent on this issue, we believe that clarification in the legislation would be useful to guard against potential challenges to the Board's practice.

**17.62** The Board decided that it would not retroactively assert jurisdiction over products whose patents had been dedicated before 30 January 1995. However, it maintains that it has the discretion to investigate complaints about the pricing of these products, should it decide to do so. There is no standard or set of factors established for the Board to consider in the exercise of this discretionary power. In our view, such a standard would need to be in place to avoid any perception of arbitrary conduct by the Board.

**17.63 Voluntary compliance undertakings.** As a quasi-judicial body, the Board can determine whether a price is excessive and can issue a remedial order only after following a public hearing process. When the Board finds that the price of a patented drug is excessive, it can order the patentee to lower the price and, in order to offset the excess revenue the manufacturer has received, to make further price reductions or remit an amount to the Crown. The legislation states that the Minister of Health can enter into agreements to distribute to provinces the money collected through these orders.

The Board realized that patent dedication had become a serious problem.

**17.64** Where excessive price is suspected, the Board has adopted a policy of using voluntary compliance undertakings in lieu of holding a public hearing. (Since 1993 the Board has completed one such hearing.) If the Board confirms through an investigation that the price of a patented medicine exceeds the guidelines, before a public hearing takes place the patentee can make a voluntary compliance undertaking to adjust the price of the drug and to offset excess revenues, including making a payment to the Crown. Such an undertaking does not constitute an admission that the price of the drug product is excessive.

The Board has adopted a policy of using voluntary compliance undertakings.

**17.65** We found that this practice has certain merits. The approval of voluntary compliance undertakings can avoid time-consuming and costly formal proceedings. However, the *Patent Act* does not address their use; hence it does not authorize the Minister of Health to give the provinces funds collected through undertakings.

The approval of voluntary compliance undertakings can avoid time-consuming and costly formal proceedings.

**17.66** Between 1993 and 1996, the Board accepted 14 voluntary compliance undertakings and collected $10.2 million from drug manufacturers. In the absence of legislative authority to distribute such

money to the provinces, Health Canada had to obtain approval in 1997 for a grant to distribute the $10.2 million to provinces and territories. No legislative amendment has been proposed to provide for future distribution of money collected through voluntary compliance undertakings.

**17.67 Pharmaceutical research and development expenditures.** The Act requires the Board to report on its estimate of research and development (R&D) spending in relation to revenues from sales of medicines in Canada, by individual patentee and for all patentees in total. The legislation gives the Board substantial powers, including the power to issue an order requiring a patentee or any person to provide this information.

**17.68** The R&D expenditures in question are those that are eligible under the federal tax legislation that was in effect on 1 December 1987. While the applicable federal tax regulations have changed in the past decade, no corresponding changes have been made to the Patented Medicines Regulations.

**17.69** It is difficult for the Board to check the accuracy of reported R&D expenditures, which are based on 1987 federal tax regulations. The R&D information reported by the Board is essentially based on information certified by the patentees to be true and correct. Given that the Board's procedures to check the information are limited, so is its assurance that the information is complete and accurate. The Board's annual report contains no such caveats.

**17.70** On the basis of information submitted by patentees, the Board reported that the brand name pharmaceutical industry had met its commitment to increase annual R&D spending to 10 percent of sales by 1996.

**17.71** Given that this commitment has been met, there is a need to review whether the reporting of pharmaceutical R&D expenditures continues to be relevant. Should the Board continue to report this information, there is a need to assess whether there are more cost-effective means of obtaining and reporting these data, considering the limited resources of the Board.

**17.72** Some of the weaknesses we noted could be addressed through amendments to the legislation, or through regulation where the *Patent Act* permits.

**17.73 The Patented Medicine Prices Review Board should, in consultation with Health Canada and Industry Canada, bring to the attention of the government the need to review the legislation and regulations relating to patented medicines in order to:**

- **examine the relevance of the price factors as well as the use of comparisons with prices in the foreign countries listed in the regulations;**
- **clarify the jurisdiction of the Board over patented medicines whose patents are dedicated for public use;**
- **address the future distribution of money collected through voluntary compliance undertakings; and**
- **review the continued relevance of the requirement for reporting pharmaceutical research and development expenditures.**

***Board's response:*** *The Board is currently consulting with stakeholders on issues within its jurisdiction such as its price methodologies, the calculation of foreign prices, and the application of the guidelines in cases where the drug is only sold in a small number of countries. If the Board concludes that changes to the legislation or regulations are required in order to fulfil its legislative mandate, it will make recommendations to the government. The Board is also vigilant in watching for evidence of practices, such as patent dedication, to avoid its jurisdiction and will recommend that anti-avoidance measures be incorporated in the Act if necessary. The Board will*

*bring the other aspects of this recommendation to the attention of the appropriate ministers and is prepared to work with them.*

## Review of Prices of Patented Medicines

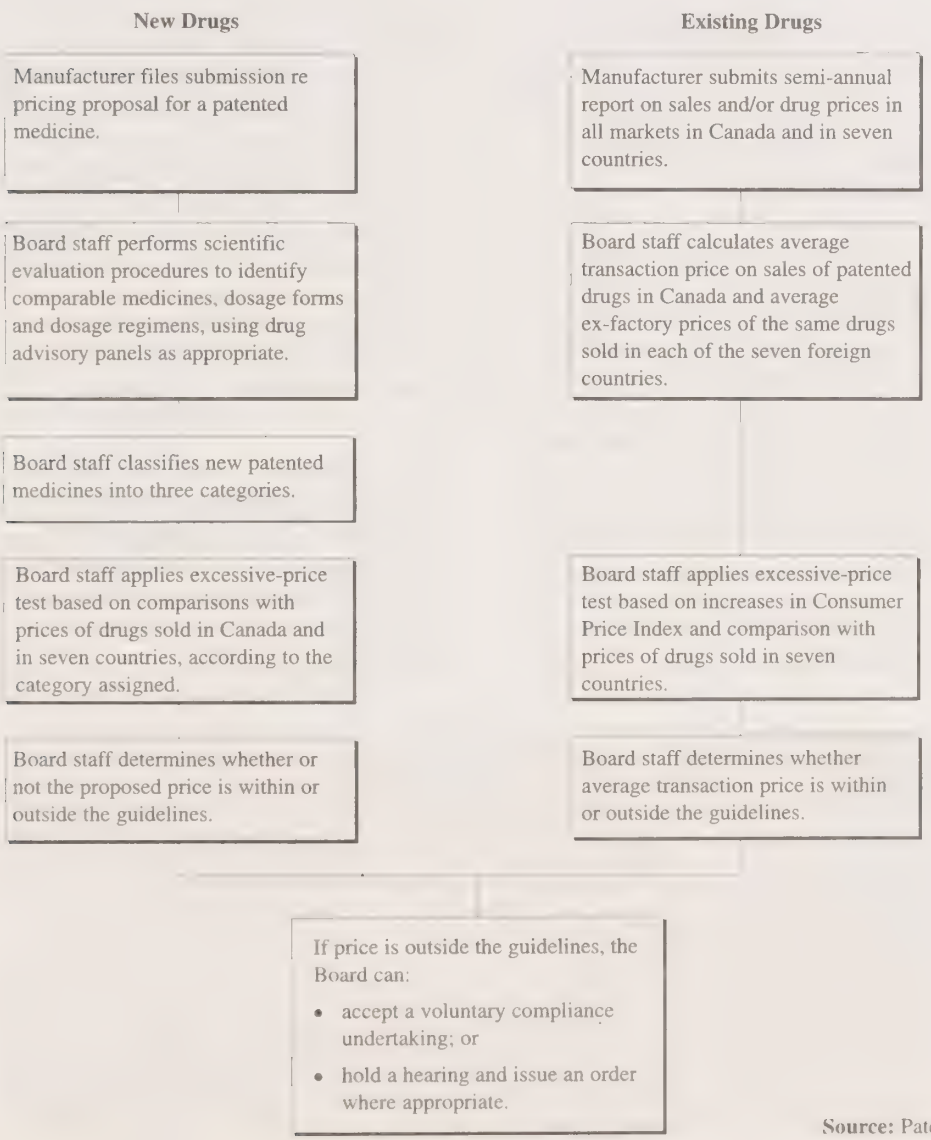
### Most patented drug prices comply with the Board's guidelines

**17.74** The core activity of the Board is to ensure that the prices charged by manufacturers of patented medicines are not excessive. Exhibit 17.5 depicts the processes for reviewing introductory prices of new patented medicines and reviewing prices of patented drugs that are already on the market. In 1997, a total of 991 different patented medicines were sold in Canada; 98 of these were new drugs introduced during the year.

**17.75** According to the Board's 1997 data, most patented drugs sold in Canada comply with the Board's guidelines on

**Exhibit 17.5**

**Overview of the Price Review Process**




**Source:** Patented Medicine Prices Review Board

We found that guidelines were generally applied rigorously. However, we observed a small number of cases where reasons for decisions were not clear or transparent.

excessive prices. Approximately 85 percent of the new and existing patented drugs were considered to be priced within the guidelines. Only approximately two percent of the drug products whose prices appeared to exceed the guidelines were being investigated or were subject to further review. The Board will commence an investigation only when certain criteria are met (Exhibit 17.6). About 13 percent had prices that exceeded the maximum level established by the guidelines, but the excess revenues were deemed too small to warrant an investigation.

**17.76** In its 1997 annual report to Parliament, the Board reported that the products in the latter group were within the guidelines, although consumers had paid prices higher than the established maximum. The prices either exceeded the maximum annual price increase allowed in relation to changes in the CPI or, in a few instances, were the highest among the seven foreign countries. The total cumulative excess revenues or cost to consumers of these products together amounted to approximately $1.2 million at 31 December 1997. In our view, it is not appropriate to report these products as priced within the guidelines.

### Need to ensure that price review decisions are clear and transparent

**17.77** The Board's guidelines are not a rigid set of decision-making rules and are not binding on the Board. However, we expected that established guidelines would be applied rigorously and consistently, and that the reasons for exceptions or non-application of the guidelines would be clear and transparent.

**17.78** We found that guidelines were generally applied rigorously. However, we observed a small number of cases where prices exceeded guidelines but the Board's reasons for making exceptions or not applying the guidelines were not clear or transparent.

**17.79** In one such case, the Board decided not to commence proceedings under the Act on the grounds that, given the cost of holding a public hearing, it would serve no useful purpose. The cumulative excess revenues amounted to approximately $52,000 at the time this decision was made. However, the Board's files contained no reference to any threshold and no indication as to what level of excess revenues would trigger further action. The Board's 1997 data show that the cumulative excess revenues for this product, which is still on the market, have exceeded $157,000.

**17.80** In another case, the international price comparison guideline was not applied to limit the introductory price of a new drug product. In this case, the Board staff closed the investigation even though the guidelines stipulate that the price of a patented drug in Canada can at no time

Exhibit 17.6

**Criteria for Initiating a Price Investigation**

**For existing drug products:**

- A price is 5% or more above the maximum non-excessive price and there are cumulative excess revenues of $25,000 or more over the life of the patent after 1 January 1992.
- Cumulative excess revenues are $50,000 or more over the life of the patent after 1 January 1992.
- Complaints with significant evidence are filed.

**For new drug products:**

- The introductory price is 5% or more above the maximum non-excessive price.
- Excess revenues in the introductory period are $25,000 or more.
- Complaints with significant evidence are filed.

**Source:** Patented Medicine Prices Review Board

exceed those in the foreign countries. Since 1995 this product has had a higher price in Canada than in other countries and is still being sold here. Had the guidelines been applied, the Board's analysis shows that the cumulative excess revenues would have amounted to approximately $4.896 million in the period from March 1995 to December 1996.

**17.81** In a case in 1993, the Board decided to proceed with a public hearing concerning a drug in a particular category. However, having received submissions from the parties involved, the Board accepted a voluntary compliance undertaking whereby the patentee agreed to pay $1.755 million to the Crown to offset excessive pricing. But the guidelines for that category of drug were not applied in determining the amount to be paid in the undertaking. Had the Board applied the guidelines for that category of drug, the amount paid would have been several times higher. The Board issued reasons for accepting the undertaking, but provided no adequate explanation of the basis on which the payment was calculated.

**17.82 The Patented Medicine Prices Review Board should ensure that its guidelines are rigorously applied, or are revised if they are considered inappropriate. The Board should also ensure that in cases where exceptions are made or its guidelines are not applied, the reasons for and effects of its decisions are clear and transparent.**

***Board's response:*** *We agree. The Board is currently consulting on matters that may warrant further revisions to its guidelines and on how it may provide more information with respect to its price review activities.*

*The Board notes that the Auditor General found that the guidelines are generally applied rigorously. As he has noted, the Board cannot, by law, be bound by its guidelines. The three cases referred to in the chapter were handled in conformity with the Act; the Board made no finding of excessive pricing following its investigations. The Board agrees, however, that it should try to find ways consistent with the law and principles of fairness to report more information on the outcome of investigations.*

**The Board relies on price information that often it cannot check for accuracy**

**17.83** As we have noted, there are inherent difficulties in checking the drug price information filed by patentees.

**17.84** The Board relies on companies themselves to report the price information. The Board staff expends considerable effort attempting to check its accuracy. They compare the foreign price information with publicly available reference sources and with the previous year's prices to check the reasonableness of the information. If a formal investigation is required, the Board staff will also attempt to contact foreign authorities to verify the prices.

The Board has recognized the need to validate foreign price information.

**17.85** In 1997, the Board contracted a firm to undertake a limited review of foreign drug price information filed by patentees. The review found, as would be expected, that the prices submitted by patentees were, on average, below the wholesale or retail prices listed in the public reference sources. However, it could not verify that prices filed were indeed the manufacturers' prices.

**17.86** The Board has recognized the need to validate foreign price information. It continues to discuss this with foreign authorities and has initiated steps to review a sample of the prices at which patented drugs are sold to foreign wholesalers and pharmacies. The Board noted that it has not attempted to check manufacturers' prices to hospitals in foreign countries because the information is often not publicly available.

**17.87** The Board receives domestic price information from the pharmaceutical

companies and, in most cases, accepts the information as accurate. The Board relies on this information in determining whether or not prices charged by the companies are excessive. The Board staff conducts some reviews to identify anomalies and inconsistencies in an attempt to check the accuracy of the price data, but does not do a systematic check on a regular basis.

**17.88** The Board essentially relies on companies themselves to report the data on which the regulation of their drug prices is based. We would expect that the Board would attempt to do more to obtain a reasonable level of confidence in the accuracy of the data.

**17.89** We believe that the Board needs to identify cost-effective means to check the accuracy of the price information in order to enhance public confidence in its price review work. For example, patentees could have their price information certified as part of their annual audit.

**17.90 The Patented Medicine Prices Review Board should, in performing its price review work, identify cost-effective means to check the accuracy of price information submitted by patentees.**

***Board's response:*** *The Board agrees that it is essential to ensure public confidence in its price review work and to ensure compliance with the Act. The Act provides significant penalties for failure to file accurate information, including jail terms and fines up to $25,000 per day. Although the Board has no evidence of wrongdoing, it will continue to seek out cost-effective means to verify price information.*

**Co-ordination of scientific reviews of new drugs needs to be strengthened**

**17.91** The Board conducts scientific reviews to categorize new drugs for price review purposes. The category assigned will affect the introductory price of the new medicine.

**17.92** The scientific reviews of new drug products entail obtaining detailed information on drug products from the manufacturer and using the recommendations of an independent, three-member drug advisory panel. Where necessary, the panel considers advice from other experts.

**17.93** Approximately seven percent of new drugs are categorized as a category 2 — a "breakthrough", or a drug that provides a substantial improvement over comparable existing products. Only the advisory panel can recommend that a new drug product be considered a category 2 drug.

**17.94** Health Canada is responsible for approving drugs for sale in Canada. The Department ensures that the drugs available are safe, effective and of high quality. Prompted by the urgent need to provide Canadians with the best available therapies for serious and life-threatening diseases, the Department has introduced a policy for the priority review of drug submissions. The Department grants a priority review status to drug submissions that meet either of the following criteria:

- there is substantial clinical evidence that the drug provides effective treatment, prevention or diagnosis of a disease or condition for which no drug is presently marketed in Canada; or
- there is substantial clinical evidence that the drug provides significantly improved efficacy or significantly diminished risk over existing therapies, preventatives or diagnostic agents for a disease or condition that is not adequately managed by a drug marketed in Canada.

**17.95** Health Canada grants priority review status prior to a full review of the data package; the review might demonstrate that in fact the drug does not provide the significant advance anticipated. While the Board and Health Canada have different objectives, they both attempt to determine whether a drug provides significant improvement over

existing therapies. We observed cases that met Health Canada's criteria but that were nonetheless categorized by the Board as drugs that do not provide substantial improvement over comparable existing products.

**17.96** We believe that the Board needs to explore opportunities to share information with Health Canada, to the extent practical.

**17.97 The Patented Medicine Prices Review Board should explore opportunities to improve the co-ordination of its work with Health Canada in performing scientific reviews to categorize new patented medicines.**

***Board's response:*** *The Board and Health Canada have regular contacts and share a good deal of information; we will continue to review our requirements and enhance these arrangements as necessary. Nonetheless, these agencies have different responsibilities and it is essential that any "co-ordination" not constrain the Board's duty to determine, in a public hearing, if a price is excessive.*

## Reporting of Drug Price Trends

### Improvements required in reporting of drug price trends

**17.98** The Board is required to submit an annual report to Parliament that includes a summary of pricing trends for all drugs, both patented and non-patented. We expected that the Board would report complete, relevant and reliable information on drug price trends, supported by adequate analysis.

**17.99** The Board has developed a Patented Medicine Price Index to report on price trends for patented drugs. The index measures the change in aggregate prices of all patented drugs that are on the market during at least two consecutive six-month periods.

**17.100** As the Board does not have jurisdiction over prices of non-patented drugs and lacks information on them, it has to resort to other sources of information. Since 1996, the Board has used the Industrial Product Price Index (IPPI) published by Statistics Canada to derive a Non-Patented Medicine Price Index (NPMPI).

**17.101** The Industrial Product Price Index for pharmaceuticals is a monthly index that measures price changes of major patented and non-patented drugs sold in Canada, as well as exports of drug products produced in Canada.

**17.102** We identified differences between the Board's patented and non-patented drug price indices and those published by Statistics Canada. The Board reported that the Non-Patented Medicine Price Index showed an annual growth of 2.5 percent in 1996 and a decline of 1.3 percent in 1997. However, in its corresponding index, Statistics Canada reported a growth of only 0.1 percent in 1996 and a decline of only 0.4 percent in 1997. The Board did not use Statistics Canada's non-patented medicine price sub-index because it found it unreliable. However, it is part of the Industrial Product Price Index, which the Board does include in its annual report.

**17.103** Although Statistics Canada has updated its IPPI to use 1992 as the base year, the Board did not show the revised IPPI figures in its 1997 annual report. We urge the Board to work with Statistics Canada to improve the reporting of drug price trends and to minimize any potential duplication of effort.

**17.104 The Patented Medicine Prices Review Board should work with Statistics Canada to improve the reporting of drug price trends.**

***Board's response:*** *The Board has always discussed methodological and other issues with Statistics Canada but agrees that more can be done to improve the reporting of drug price trends in Canada. It has*

While the Board and Health Canada have different objectives, they both attempt to determine whether a drug provides significant improvement over existing therapies.

*recently established a task force with representatives of Statistics Canada for that purpose.*

## Board Administration

**An appropriate financial control framework is in place**

The Board has most of the important features of financial control for an agency of its size and financial complexity.

**17.105** We assessed the financial management capability of the Board, including its financial control framework. In our view, the Board has most of the important features of financial control for an agency of its size and financial complexity, with financial management capabilities focussed primarily on meeting central agency requirements. It has a control framework in place to ensure that money is spent in accordance with applicable authorities.

**17.106** Approximately 70 percent of the Board's annual expenditures of approximately $3 million are related to payroll costs. The remainder is spent mainly on contracting for legal and professional services and on other administrative expenditures. We identified a few cases where the Board had entered into contracts contrary to government contracting regulations. For example, it gave contracts valued at over $25,000 each to one firm and one individual on a non-competitive basis. However, nothing of a significant nature has come to our attention to indicate that expenditures were not properly incurred.

## Conclusion

**17.107** The Patented Medicine Prices Review Board regulates the prices of patented medicines in accordance with the *Patent Act* and the associated regulations, with the exception of some requirements in the legislation and regulations that are difficult to apply in practice. Consideration needs to be given to reviewing the continued relevance of those requirements.

**17.108** Most patented drugs comply with the Board's guidelines. However, the Board needs to ensure that its price review decisions are clear and transparent. The Board also needs to identify cost-effective means to check the accuracy of price information submitted by patentees.

**17.109** The Board has taken steps to assess the impact of federal regulation of patented drug prices. Several factors other than the Board's activities also influence the price of patented medicines, but the Board's measurement of its impact did not assess the effects of these other factors. In reporting to Parliament, the Board did not clearly identify the limitations of the estimates of its impact. As it continues to measure its effectiveness, it is important that the Board identify the results that are attributable solely to its activities.

**17.110** The Board has developed price indices to report to Parliament on price trends for patented and non-patented drugs. However, it needs to work with Statistics Canada to improve the reporting of drug price trends.

**17.111** The Board reports to Parliament on pharmaceutical research and development expenditures essentially on the basis of information filed by patentees. Given that the Board's procedures to check the information are limited, so is its assurance that the information is complete and accurate.

**17.112** Finally, with respect to its administration, the Board has most of the important features of financial control for an agency of its size and financial complexity, with financial management capabilities focussed primarily on meeting central agency requirements.



# About the Audit

## Objectives

- To determine whether the Patented Medicine Prices Review Board regulates the prices of patented medicines in accordance with relevant legislation and regulations.
- To determine whether the Board reports to Parliament complete and reliable information on:
  - the extent to which its price review activities affect prices of patented medicines;
  - price trends for all drugs; and
  - research and development spending by pharmaceutical patentees.
- To determine whether the Board manages its operations efficiently in the areas of administrative expenditures, contracting and human resources.

## Scope

The audit examined the Board's price review activities and its reports on drug price trends, research and development spending by pharmaceutical patentees, and the impact of federal regulation of prices of patented medicines. We analyzed in detail a sample of price submissions for 80 drug products. We also examined the Board's compliance and enforcement activities involving investigations and voluntary compliance undertakings. We had extensive discussions with the Board staff and observed the Board's ongoing consultation with stakeholders during the audit. In addition, we reviewed various studies and reports published by the Board and other documentation.

The audit did not examine the approval of drugs, granting of patents and the Patented Medicines (Notice of Compliance) Regulations. These areas are outside the Board's jurisdiction.

The quantitative information in this chapter that has been drawn from government sources or the Board's data bases has been checked for reasonableness but has not been audited.

## Criteria

We expected that:

- The Board would clearly identify and communicate its role and mandate to stakeholders.
- There would be established practices for the review of prices of patented medicines, in compliance with the legislative and regulatory framework.
  - Legislation and regulations would be complied with and enforced.
  - Where the legislation and regulations pose constraints for compliance and enforcement, changes to legislation and regulations would be proposed where necessary.
  - Established guidelines and price review methodology including criteria for making exceptions would be sound, clear and consistently applied.

  - Review of prices of patented medicines including scientific reviews, verification of data submitted by patentees, price comparisons, investigations, enforcement and remedial actions would be efficient and effective, in compliance with authority and established policy and guidelines.
  - The price review process including decisions on investigations and voluntary compliance actions taken would be transparent to the public.
  - Judicial proceedings would be conducted consistent with legislation and established rules for the practices and procedures of the Board.
- There would be established procedures to measure performance and report results. Parliament would be provided with relevant, reliable and understandable information on the performance of the program, including intended and unintended effects of the Board's price review activities.
- The Board would report complete, relevant and reliable information on pricing trends in the pharmaceutical industry, supported by adequate analysis.
- The Board would report complete and reliable information on the ratio of research and development expenditures to sales revenues for individual pharmaceutical patentees and for all pharmaceutical patentees as a whole, supported by adequate analysis.
- The Board would have the financial management capability it needs to meet its responsibilities, including appropriate controls to ensure that expenditures for goods and services are incurred properly and payments pursuant to remedial actions are collected as authorized.
- The Board would have established sound practices to manage its human resources.

## Audit Team

Assistant Auditor General: Maria Barrados
Directors: Ronnie Campbell and Gerry Chu

James S. Blain
Lisa Drouillard
Joanne Moores

For information, please contact Gerry Chu.

# Report of the Auditor General of Canada to the House of Commons – 1998

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# Report of the Auditor General of Canada to the House of Commons

## Chapter 18
The Financial Information Strategy: A Key Ingredient in Getting Government Right

**September 1998**

Report of the

# Auditor General of Canada

to the House of Commons

## Chapter 18

The Financial Information Strategy: A Key Ingredient in Getting Government Right




September 1998

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# Chapter 18

## The Financial Information Strategy: A Key Ingredient in Getting Government Right

*The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.*

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# The Financial Information Strategy: A Key Ingredient in Getting Government Right

## Main Points

**18.1** Under the Financial Information Strategy (FIS), the government is making sweeping changes in the type of financial information provided to decision makers. FIS involves the move to full accrual accounting similar to that used by business firms, the implementation of new financial systems and the integration of full accrual financial information into day-to-day decision making of departmental managers. When fully implemented, by 2001 according to the current plan, FIS should help the government strengthen significantly its management of business lines and its accountability to Parliament. The government has clearly indicated that it is committed to *getting government right* and has established FIS as one important initiative in doing this. The Office of the Auditor General fully supports the stated objectives of FIS.

**18.2** FIS began a decade ago. Progress in the early years was slow, but in recent years the tempo of work has picked up. To date, FIS has focussed on implementing new departmental financial systems that are Year 2000-compliant and on ensuring that departmental and central systems will provide appropriate information to include in the government's annual financial statements.

**18.3** However, the government has yet to implement its plans to deal with the important area of making full accrual financial information available to officials within departments and agencies who manage business lines and related components on a day-to-day basis. One of the objectives of FIS is to provide officials with more complete information on costs to compare with results achieved when making key decisions. Until this is done, the full benefits of FIS will not be realized.

**18.4** While better cost information for decision making is a benefit of FIS, we note that neither individual departments nor the government overall are aware of the full costs of FIS implementation, which could be significant.

**18.5** The government and Parliament can help ensure the success of FIS by appropriating funds on a full accrual basis, so that accountability and reporting are on the same basis. But central agencies and individual departments must also act to help ensure that the full benefits of FIS are achieved. Central agencies must secure complete departmental "buy-in", and deputy ministers of individual departments must put in place the necessary infrastructure, including appropriate systems and human resources.

**18.6** Departments face a major challenge in completing the renewal of their financial systems to meet the objectives of FIS. Best practices and lessons learned from others who have gone before can help achieve success.

**18.7** Given the massive scale of financial systems renewal now under way to meet the Year 2000 challenge, we believe that there is a unique opportunity to put FIS in place by the 2001 target implementation date. This is not a simple task. To obtain the full benefits of FIS and thus have in place the information required for government today, the challenges faced by the government and summarized in this chapter must be met. In future audits, we will continue to track the government's progress in implementing FIS and achieving these benefits.

## Introduction

### Getting government right

**18.8** In his 1994 Budget, the Minister of Finance announced Program Review "to ensure that the government's diminished resources are directed to the highest priority requirements and to those areas where the federal government is best placed to deliver services." In the 1995 Budget, the Minister explained that Program Review would lead to long-lasting structural change in *what* the government does. He spoke in terms of *getting government right.*

**18.9** In 1995, the President of the Treasury Board announced a new Expenditure Management System (EMS) to ensure that the scrutiny of government spending initiated under Program Review became a permanent feature of public sector management. To operate in this new environment, government managers and parliamentarians alike need reliable information to help them assess and scrutinize the efficiency and cost effectiveness of ongoing activities. To help meet this need, the Minister of Finance announced in his 1995 Budget, "the government intends to adopt 'full accrual accounting', which is comparable to private sector practice." He further noted, "This change will better enable the government to report the true cost of programs and improve accountability."

**18.10** The government's Financial Information Strategy (FIS) is one of the key vehicles being used to put these changes in place. The 1997 report of the President of the Treasury Board, entitled *Getting Government Right,* stated that FIS "is intended to lead to a model for financial management and accounting comparable to the private sector." The government's current vision, mission and

**The Financial Information Strategy will bring to government full accrual (businesslike) accounting, new financial systems and better information for managing.**

**Exhibit 18.1**

**FIS Vision, Mission and Tactics**

**Vision**

The vision for FIS is to enhance the government's decision making and accountability, and to improve organizational performance through the strategic use of financial information.

**Mission**

The Financial Information Strategy is to be fully implemented by the year 2001, in order to:

- better support program review, business planning, budgeting, expenditure management, and other management and decision making processes; and
- facilitate accountability for program and financial results by enabling improved estimates and performance reporting to Parliament.

**Tactics**

In order to achieve the mission, the Financial Information Strategy will:

- change the basis of accounting from the current modified accrual basis to full accrual accounting, including the capitalization of fixed assets;
- implement a new chart of accounts for government-wide reporting;
- decentralize accounting to departments, with the Receiver General continuing to undertake the government's treasury function and produce the consolidated government-wide financial statements;
- allocate the responsibility for payment scheduling to departments;
- modernize the central accounting system by developing the Central Financial Management Reporting System (CFMRS);
- improve departmental systems to include integrated financial and materiel processes, and to take advantage of new technology; and
- foster a learning environment in which managers steadily improve their ability to use quality financial information for strategic purposes.

**Source:** FIS: A Summary, January 1997

The quality of federal government financial information continues to be significantly below acceptable standards in the private sector.

tactics for the implementation of FIS are described in Exhibit 18.1. In our view, some significant implications of FIS involve the move to full accrual accounting practices similar to those used by business firms, the implementation of new financial systems throughout government and the integration of full accrual financial information into day-to-day decision making of departmental managers. The Appendix to this chapter provides more information on the historical background leading to FIS.

**18.11** FIS was formally approved nearly a decade ago, was revitalized in 1995 and now has a target implementation date of 2001. As Exhibit 18.2 illustrates, the quality of financial information within the federal government, for both management and accountability, continues to be significantly below acceptable standards in the private sector. Getting government right in the years ahead will require that this disparity be eliminated.

**18.12** In his 1997 annual report entitled *Accounting for Results,* the President of the Treasury Board noted that in order to demonstrate accountability to taxpayers, "the government needs the capacity to measure activities (outputs) and results ... and to link these both to results commitments and to the **resources used.**" *(emphasis added)* Furthermore, he noted in his report that FIS "aims to enhance government decision making and accountability and to improve organizational performance by providing more complete information on the **costs of programs and activities**." *(emphasis added)*

**18.13** These statements highlight the importance and high expectations being placed by the government on FIS. We agree with the government that FIS is an important initiative in getting government right. This chapter is the first in a series of chapters on FIS over the next few years that aim to provide Parliament with an

Exhibit 18.2

Private Sector, Federal Government and Proposed FIS Practice

| | Private Sector Practice | Federal Government Practice | Planned Under FIS |
|---|---|---|---|
| **Government-wide financial information** | | | |
| • Financial statements that report all assets and liabilities | Yes | No | Yes |
| • Monthly financial statements on the same basis as the annual statements | Yes | No | Yes |
| • Annual financial statements available soon after the fiscal year end | Yes | No | Yes |
| • Annual financial statements that are audited | Yes | Yes | Yes |
| **Departmental financial information** | | | |
| Complete, accurate, relevant and timely financial information, for example: | | | |
| • to set prices and fees or to recover costs; | Yes | Ad hoc | Yes |
| • to assess stewardship of assets and liabilities; | Yes | Ad hoc | Yes |
| • to assess efficiency and cost effectiveness of operations; | Yes | Ad hoc | Yes |
| • for use in selling or restructuring operating units; and | Yes | Ad hoc | Yes |
| • for lease versus buy decisions. | Yes | Ad hoc | Yes |

independent reporting on its development and implementation.

### A 35-year call for improved financial information

**18.14** For 35 years, there has been a common call for improvements in financial information to support government decision making. Exhibit 18.3 describes some of the key recommendations of the various reviews that have taken place. The scope of FIS was broadened in 1995 from an initial focus on the government-wide needs of central agencies to include improvements in financial information for management and accountability within individual departments and agencies.

### FIS is a key component of the government's overall vision of comptrollership

**18.15** In response to a recommendation by the Independent Review Panel on the Modernization of Comptrollership in the Government of Canada, the President of the Treasury Board announced in January 1998 that the government had committed itself to modernize its approach to comptrollership — "to move it from a narrow and specialized function to a core responsibility of every manager in the public service." In its 1997 report, the Panel described comptrollership as including management decision making and public reporting that is based on integrated financial and non-financial information, the creation of a mature risk management environment, the development of appropriate control

For 35 years, there has been a common call for improvements in financial information.

**1962 – Royal Commission on Government Organization (Glassco Commission)**

"An accounting system, capable of facilitating decision making by management, should provide complete costs of activities."

**1979 – Royal Commission on Financial Management and Accountability (Lambert Commission)**

"... [that] comprehensive cost-based accounting systems be developed and used in all federal departments and agencies, and that these systems meet the criteria of capturing all costs on a timely and accurate basis and be integrated with costing systems capable of analyzing the data thus obtained."

**1987 – Office of the Auditor General, Chapter 4, Financial Management and Control Study (FMCS)**

- Few financial systems provide both financial and operational data.
- Current information for managers tells them where they stand in relation to their budget but NOT the cost-effectiveness of their operations.
- Although operational data are available, they can rarely be related to financial data so as to determine the costs of specific operations.
- The concept underlying financial management is that objectives, results and resources should be linked.

**1997 – Independent Review Panel on Modernization of Comptrollership in the Government of Canada**

"The Panel believes modern comptrollership is about ensuring that management decision making has the benefit of rigorous, complete and integrated financial and non-financial, historical and prospective performance information as well [as] appropriate advice, analysis and interpretation of this information."

Exhibit 18.3

Previous Calls for Financial Information Reform

Exhibit 18.4

**Comptrollership and FIS**

systems, and values and ethical practices permeating throughout the organization.

**18.16** This view of comptrollership embraces our definition of financial management in a government context, as described in Chapter 2 of our 1997 Report. Exhibit 18.4 is a graphical representation of the relationship of FIS to this vision of comptrollership. Successful completion of FIS is required as a pre-condition to being able to deliver on some of the main elements of modern comptrollership, including public accountability reporting, integrated financial and non-financial performance information for decision making, responsive and appropriate control systems and a mature risk management environment.

**FIS implementation is a shared responsibility**

**18.17** The Financial Information Strategy is a huge project that will have an impact on every department and agency of the Government of Canada. Such a project requires leadership, co-ordination and co-operation throughout all of its stages.

**18.18** At the centre, the Treasury Board Secretariat has established a FIS Project Office to provide leadership across government by managing and co-ordinating the development and implementation of FIS in departments and central agencies.

**18.19** The Receiver General is responsible for the development and implementation of a modernized suite of central systems, including the replacement of the current Central Accounting System, that will support the new departmental financial systems, and will accept the summary-level financial data from departments. These data would then be used to produce the monthly Fiscal Monitor, the annual summary financial statements of the Government of Canada and other government-wide information.

**18.20** Departments are responsible for implementing new financial systems within their organizations in a manner that supports the objectives of FIS. Departments are also responsible for the quality of the information that they generate to support their departmental decision making process and that they provide to the centre for preparation of the government's summary financial statements.

FIS is a key component of the government's vision of comptrollership.

## Strategic Challenges in Realizing the Full Benefits of FIS

**Integration of FIS into departmental management**

**18.21** As described in the Appendix and in Exhibit 18.3, the common theme in studies of financial management in the Government of Canada over the past 35 years has been the need for improved financial information for parliamentary oversight and management decision making. In this context, management decision making refers to decisions at both the overall government level and the level of the departmental line manager.

**18.22** In his 1997 report entitled *Accounting for Results,* the President of the Treasury Board re-emphasized this call for improved financial information for management decision making by noting:

> In general, however, existing sources of information do not answer questions about the costs associated with specific results. Although conclusive information linking costs and results is often difficult to obtain, improvements are being made through the government's Financial Information Strategy. The Strategy aims to enhance government decision making and accountability and to improve organizational performance by providing more complete information on the **costs of programs and activities**. *(emphasis added)*

Understandably, the current focus has been on implementing departmental systems that are Year 2000-compliant and that provide accounting information for external reporting.

**18.23** The government has clearly placed high expectations on FIS to provide better financial information for management decision making. To support these high expectations, the government is investing significant resources in the FIS initiative. The main emphasis to date has been to implement new departmental financial systems that are Year 2000-compliant and to ensure that these and the associated central systems will eventually provide financial accounting information to meet the new requirements for external reporting under FIS (for example, preparing the government's summary financial statements on a full accrual basis).

**18.24** To achieve the broad vision of FIS, the government recognizes the need to enhance an additional area — the use within individual departments and agencies of financial information on the cost of business lines and related components for comparison with results achieved. The new financial systems need to be implemented with an emphasis on providing this improved information for management decision making, both directly and through the integration of these systems with specialized costing systems. If this is not done as part of the initial system design, then additional investment may be required to modify these new systems beyond their current financial accounting focus to ensure that the objectives of FIS are fully met.

These new systems must also provide information that enables managers to compare costs with results achieved.

**18.25** In our future audits, we will assess the progress being made within specific departments in implementing financial systems capable of capturing all relevant costs for key management decision making and in integrating these systems with specialized costing systems capable of analyzing the data captured.

**18.26** What needs to be done to ensure that these new departmental systems are implemented in a way that finally answers the call for improved financial information for management decision making? We believe that a major part of the answer lies in the need to establish appropriate incentives for change, by moving to accrual-based appropriations and by obtaining departmental "buy-in".

**Moving to accrual-based appropriations**

**18.27** As previously described, there has been overwhelming recognition, both internal and external to government, that improved financial information is needed for management decision making. The question of why this need has not been filled over the years remains unanswered. We believe, however, that the root of the problem lies with how ministers and, through them, deputy ministers and their managers are held to account by Parliament.

**18.28** Parliament controls the public purse through the granting of supply — setting limits on the amount of money available to managers to *acquire* resources. It does this by approving the *Appropriation Act,* which identifies, by spending authority (vote), the amount of money available to the government. As a result, departmental planning, managing and reporting are primarily concerned with spending money to acquire resources. But governments do not exist to *acquire* resources; they exist to deliver programs and services and, in doing so, they *consume* or *use* resources. For example, a government may acquire a building in a particular year to help deliver a program over many years. In doing so, a portion of the building's cost is consumed each year.

**18.29** Accordingly, a far better basis to plan, manage and report departmental operations is to focus on *the cost of resources consumed*, which requires full accrual accounting as envisioned by FIS. Exhibit 18.5 provides an example of the impact of full accrual accounting on departmental managers. As stated earlier, in 1995 the Minister of Finance announced the government's intention to adopt full accrual accounting for the preparation of the annual Budget and for

reporting back to Parliament on financial results in the Public Accounts of Canada. In addition, the government has informed us that it intends to ask departments to prepare their Reports on Plans and Priorities and their departmental Performance Reports on a full accrual accounting basis. These annual documents provide financial and non-financial information on departmental plans and priorities for the upcoming year and on performance against these plans after the end of that year.

**18.30** While four important accountability documents referred to above — the Budget, the Public Accounts, Reports on Plans and Priorities and departmental Performance Reports — are all moving to a full accrual basis, the government has not announced any plans to ask Parliament to appropriate resources on this same basis. This leaves out the fifth important accountability document — the Main Estimates and the associated appropriations. In our view, the likelihood of encouraging departmental planning, managing and reporting to focus on resources consumed to achieve results will significantly increase if supply moves to a full accrual basis and ministers, deputy ministers and government managers are held to account on this new basis. As can be seen in Exhibit 18.6, appropriating funds on a full accrual basis is currently the missing link in the government's plans to move to full accrual accounting.

**18.31** The benefits of a full accrual basis of accountability were stressed as far back as 1962. The Glassco Commission believed that moving in this direction would provide:

- greater cost consciousness leading to better use of resources;
- improved decision making leading to better allocation of resources; and
- better evaluation of performance leading to better accountability.

**18.32** The benefits of an accrual-based appropriation (supply) process, for both management and Parliament, have gained international as well as domestic acceptance. Australia, the United Kingdom and New Zealand as well as the Province of Alberta have either moved to or plan to move in the near future to an accrual-based appropriation process.

**18.33** Accrual-based supply would also benefit Parliament's oversight responsibilities by providing parliamentarians with consistently prepared information that facilitates linking plans and supply with results achieved. Aligning the supply process with the same basis of accounting the government will use for planning,

**Governments exist to deliver programs and services and, in doing so, they consume resources.**

Exhibit 18.5

**The Impact of Full Accrual Accounting on Departmental Decision Making**

The biggest change for departmental managers resulting from the move to full accrual accounting will be how physical assets are accounted for. Under current accounting policy, the acquisition of physical assets is treated in the same manner as the recording of operating expenditures; the total cost is expensed in the year of acquisition.

Therefore, decisions such as those to incur a capital outlay or to lease are often influenced by the immediate needs of deficit/surplus management and not necessarily on the basis of what is more economical for the government. In addition, expensing capital acquisitions in the year acquired results in a distortion of the annual costs of individual business lines.

For example, in our 1994 chapter titled Management and Operation of Crown-owned Office Buildings, we explained that the government makes no distinction between a $25 million outlay to renovate a building that will provide benefits for perhaps 15 to 20 years and a yearly $4 million outlay to lease equivalent space in a private building.

Full accrual accounting would spread the cost of acquiring physical assets over their useful life, rather than being expensed in the year paid. This would put purchase and lease options on a common basis (cost of resources used) and would permit operational managers to make improved decisions that make economical sense to the government.

managing and reporting would facilitate oversight by Parliament.

Appropriations should focus on the use of resources instead of the acquisition of resources.

**18.34** Treasury Board Secretariat officials have informed us that they are reviewing for Parliament's consideration various options for modifying the supply process. To help achieve the full benefits of FIS, we believe that the Secretariat, in conducting this review, needs to give serious consideration to focussing the supply process on the cost of consuming resources (full accrual basis) instead of on the cost of acquiring resources.

**18.35** To help ensure that parliamentary control and authority are preserved in moving to full accrual appropriations, we believe the following basic principles are important to consider:

- clear purpose for each vote;
- dollar limits on the cost of resources that may be consumed;
- annual parliamentary scrutiny of appropriations;
- legislative support for full accrual appropriations;
- appropriation authority on the same full accrual basis as departmental planning, managing and reporting;
- government-wide treasury (cash) management oversight; and
- appropriations that distinguish between authorizing operational expenses (full accrual including depreciation) and authorizing capital investments (acquisition of capital assets).

**Obtaining departmental "buy-in"**

**18.36** While FIS is primarily a central governmental initiative, departments are in a position to make a number of critical decisions pertaining to FIS. These decisions were identified in the 1998 Treasury Board Secretariat document, FIS Training Framework. We agree fully with the Secretariat's view that only if full implementation of the FIS vision and mission is undertaken by departments will the FIS objectives be achieved.

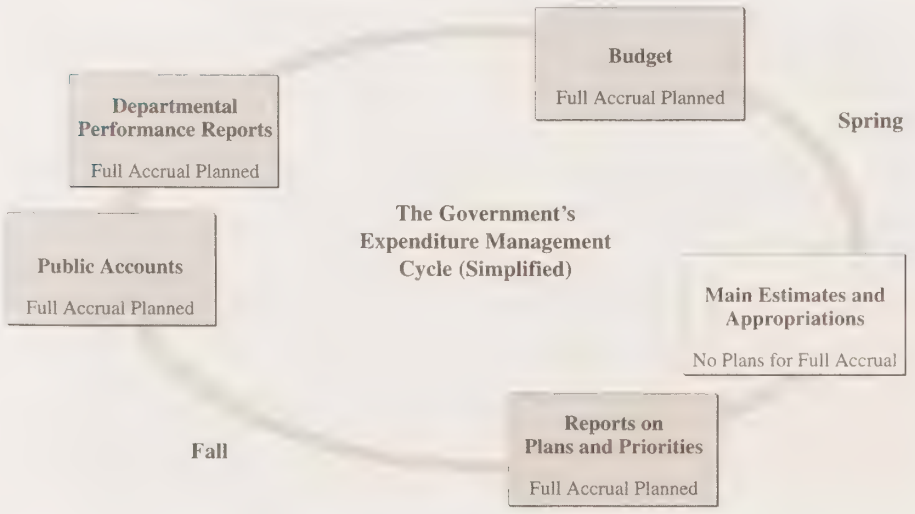
Deputy minister "buy-in" to full implementation of FIS is crucial.

**18.37** Deputy minister "buy-in" to full implementation of FIS is crucial. In this respect, the Secretariat's FIS Training Framework reported that meetings with departmental managers in 1997–98 "suggest that departmental commitment to FIS actions is not complete...." This concerns us greatly and will be reviewed in future audits.

**18.38** Central agencies have an important role to play in ensuring deputy minister commitment to the vision and

Exhibit 18.6

Appropriations: The Missing Link in the Government's Plan



mission of FIS. Rewards, recognition and, if necessary, sanctions may be needed. The Privy Council Office is responsible for the strategic management of senior personnel in support of the federal government's management agenda. As a result, it has a particularly important role to play in the success of any significant government initiative, particularly those that require the "buy-in" of deputy ministers.

**18.39** We are pleased to observe that the Secretariat intends to require departments, by 2001, to prepare the financial information within their Reports on Plans and Priorities and their departmental Performance Reports on a full accrual basis. This will encourage departments to develop, and integrate into their day-to-day management, comprehensive costing systems capable of providing the costs of individual business lines and related components to enable managers to link this information to results achieved.

**18.40** We support this intention. We believe that such a move, together with the move to accrual-based appropriations and the active support of the Privy Council Office, will encourage departments and particularly deputy ministers to integrate FIS into their day-to-day management activities.

**18.41** Departments need to put in place the necessary infrastructure, including appropriate systems and human resources, to achieve the full vision of FIS.

## Focus of the Audit

**18.42** The objectives of the audit were to review and assess the government's overall management of FIS. The audit work was carried out at the Treasury Board Secretariat, Public Works and Government Services Canada and at a selection of departments implementing new financial systems. More details on the objectives, scope and approach of the audit can be found at the end of the chapter in **About the Audit.**

# Observations and Recommendations

## FIS Project Management

**18.43 Role of the Treasury Board Secretariat.** The Treasury Board Secretariat sees its role as providing leadership, direction and advice. The Secretariat carries out its role by monitoring and facilitating the implementation of FIS at both the centre and within departments. A well-co-ordinated effort is critical to ensure that the full vision of FIS is achieved.

**18.44** We expected that the Secretariat would provide overall project management of FIS, including:

- developing an ongoing risk management process;
- providing appropriate guidance and assistance to departments;
- developing an appropriate accounting and systems framework;
- monitoring the implementation of FIS at both the centre and within departments;
- monitoring the overall costs of FIS implementation; and
- facilitating training and change management at the centre and within departments.

**18.45** Risk management of FIS overall includes three components: the FIS project office, the central systems and departmental systems. The Treasury Board Secretariat, as part of the early development of FIS, carried out a high-level risk assessment that covered all of these components.

**18.46** For the development and implementation of the central systems

The Treasury Board Secretariat accepts responsibility to monitor departmental implementation plans and is gathering information to do so.

component, the Receiver General and the Secretariat embarked on a process of joint continuous risk management in January 1997. This resulted in a risk assessment, which was completed in April 1997 and focussed primarily on the Central Financial Management and Reporting System component of the central systems. In addition, this led to joint risk management workshops, which are held periodically to identify, monitor and mitigate risks. The latest workshop was held in June 1998 with an objective to "build on previous risk assessments and identify any additional risks associated with government-wide transition and implementation of FIS." This joint risk management process identified a number of central system transition risks to be mitigated by the Secretariat, such as the need for a Master FIS Implementation Plan for years 2000 and 2001, the need for risk assessments of departmental readiness and the cost of departmental systems. The transition is the three-year period, starting in 1999, during which departments will move to the new central systems, a process that will be key to the success of FIS.

Neither individual departments nor the government overall are aware of the full costs of implementing FIS.

**18.47** To help departments with their move to the new FIS environment, the Treasury Board Secretariat has, to date, provided departments with a common chart of accounts, a departmental FIS-readiness checklist and a number of draft accounting policies. In addition, the Receiver General has provided guidance on input/output requirements. To allow them to finalize system requirements, departments are looking to the Secretariat and the Receiver General for final versions of these documents and policies as well as guidance on accounting policy areas not yet addressed.

**18.48 FIS implementation plans and costs.** The FIS implementation is scheduled to take place over three years starting in April 1999. We recognize that the Treasury Board Secretariat is aware that Year 2000 is a departmental priority at this time. However, we believe that the Secretariat needs to become fully aware of departmental FIS implementation plans and actions in order to facilitate and monitor overall progress. In this respect, we were pleased to note that the Secretariat accepts responsibility to monitor departmental implementation plans and to expand the related continuous risk assessment process. To this end, it has requested preliminary information from departments in a special section of their business plans filed in June 1998. We will review and assess the adequacy and use of this information in future audits. With few departments committing to the 1999 implementation date, and if few commit to implementing in 2000, then the last year of implementation (2001) will, by default, be extremely busy. This will place significant stress on FIS implementation at that time.

**18.49** While better cost information for decision making is an expected benefit of FIS, we note that neither individual departments nor the government overall are aware of the full costs of implementing FIS, which could be significant. We recognize that much of the work on FIS also supports other objectives such as upgrading aging financial systems and making systems Year 2000-compliant. However, we are concerned that no one is monitoring the overall cost of implementing FIS. The 1995 Treasury Board submission required that the Secretariat report back to the Treasury Board on the projected costs of FIS, including departmental implementation. This has not yet been done.

**18.50** The Secretariat recognizes that change management is important and has developed a formal FIS Training Framework. Although the time frame is short, we found this framework to be well thought out and comprehensive, with a clear recognition of the significance and broad nature of the training required to ensure success of the broad vision of FIS.

We will assess the progress of implementation of the training plan in future audits.

**18.51 The Treasury Board Secretariat should implement its plans to expand its continuous risk assessment process and to monitor and facilitate the implementation of FIS government-wide to help ensure that the full benefits of FIS are achieved.**

**18.52** In future audits, we will continue to monitor actions currently under way and planned by the Secretariat to:

- ensure that its risk management process includes all aspects of FIS, from government-wide financial reporting to information for managing departmental business lines, and covers the entire FIS implementation period, as well as that all significant risks are identified, monitored and updated on an ongoing basis;
- determine the status and completeness of the FIS implementation plans of departments and monitor their progress;
- finalize appropriate accounting and other FIS-related policies and communicate these to departments; and
- determine and report to the Treasury Board and to Parliament the full costs of FIS implementation.

## Adequacy of Control Frameworks

**18.53** The FIS vision and mission describe how FIS will enhance the government's decision making and accountability while supporting program review, business planning, budgeting, expenditure management and other management processes. We expected that the Treasury Board Secretariat would have developed guidance describing how central agencies and departments could meet this broad vision of FIS and that departments would have prepared more detailed plans covering their individual implementation.

**18.54** We found that the Secretariat had developed such guidance, referred to as the "FIS Control Framework", to describe how the financial accounting and controls will work under the new FIS environment, including a high-level explanation of the links between the central and departmental systems. This overall framework provides a guide to the development of more detailed plans required for the design and implementation of the central systems and the individual departmental financial systems. However, the framework focusses on financial accounting and controls but does not provide guidance on how to establish stronger financial management capabilities, such as the integration of FIS into departmental management decision making as outlined in paragraphs 18.21 to 18.24.

**18.55** The Receiver General has prepared a more detailed "Receiver General Control Framework" for the development and implementation of the central systems. However, the departments included in the scope of our audit had not yet prepared a detailed plan (control framework) for the post-implementation FIS environment or for the transition from the existing basis to the full accrual basis of accounting.

**The departments we reviewed had not yet prepared detailed implementation or transition plans.**

**18.56** The FIS and Receiver General control frameworks reasonably describe the financial accounting and control environment after FIS is fully implemented, but only as it relates to external financial reporting in the Public Accounts of Canada. Key types of transactions, for example, physical assets and inventories, required in future years to introduce full accrual accounting within departments for day-to-day management of business lines and related components are not included.

**The control frameworks are reasonable, but relate only to external financial reporting.**

**18.57** Departments will move to the new FIS environment over a three-year period starting in 1999. During this transition period, some departments will be FIS-compliant and some will not —

that is, some will produce financial information on the full accrual basis while others will still be using the existing accounting basis. All of this information will need to be brought together, at the centre, on one basis, to produce the summary financial statements of the Government of Canada. While the Receiver General is currently in the process of preparing an addendum to its control framework to cover this transition period, we found that the overall FIS control framework prepared by the Treasury Board Secretariat does not adequately describe the accounting and control environment that will be required during this transition period.

**18.58** Treasury Board Secretariat's FIS Master Implementation Plan lists tasks that, according to Secretariat officials, will deal with each of the matters described above. In future audits, we will monitor progress in carrying out this important work.

Ongoing risk management is critical, especially during the transition period, and is in the process of being strengthened.

**18.59 The Treasury Board Secretariat and Receiver General should implement their plans to provide guidance, such as control frameworks, covering all types of transactions required for the full implementation of FIS.**

**18.60 The Treasury Board Secretariat should implement its plans to:**

- **describe the accounting and control environment for the transition period;**
- **provide guidance to departments on the integration of FIS into departmental decision making; and**
- **facilitate the development of departmental plans that cover both the post-implementation FIS environment and the transition period.**

**18.61 Departments should develop detailed plans that set out the accounting and control requirements for both the post-implementation FIS environment and the transition period.**

## Systems Renewal: Development and Implementation of New Central Systems

**18.62** As described in paragraph 18.19, the Receiver General is responsible for replacing the current Central Accounting System with a modernized suite of central systems that will accept summary-level financial data from departments. These systems include the development of a number of new systems, including the new Central Financial Management and Reporting System and the Receiver General - General Ledger, as well as upgrading existing Receiver General systems such as the Standard Payments System, the Pay System and the Bank Facilities System.

**18.63** We expected that the Receiver General would develop central systems that met user requirements, were subject to appropriate project management procedures, and were consistent with the overall FIS control framework.

**18.64** Overall, the development of the central systems was consistent with the FIS and Receiver General control frameworks. To determine the information requirements of central agencies and other users of government-wide information, the FIS Project Office carried out a fairly extensive consultation process with Treasury Board Secretariat, Finance, Receiver General and Statistics Canada officials. These requirements were included in the formal request for proposal for the design of the new central systems.

**18.65** The Receiver General has extensive project planning and management processes for the development and implementation of the new central systems. We found that these processes, which focus on ongoing risk management, were generally working well.

**18.66** For example, the risk management process has identified that some development is behind schedule but,

according to Receiver General officials, the central systems implementation should take place as planned in April 1999. The risk mitigation plan for these schedule delays calls for the compression of the testing period and has moved the start date of the preproduction pilot several months closer to the planned implementation date. In addition, some of the central systems will not be ready to be tested until later in the preproduction pilot. This increases the risk of omission (items not tested) and leaves less time for corrective action, if problems are identified.

**18.67** Once the central systems are implemented in April 1999, there will be a three-year transition period during which departments will move from the existing Central Accounting System to the new central systems. This transition will be particularly important for the Receiver General because, during that period, there will be two central systems in operation (the old and the new). In addition, during this transition period, there are conversion risks, at individual departments as well as at the Receiver General, as departments move to the new environment. Since the risk of errors increases in an environment of constant change, the need for ongoing risk management covering this transition period is critical. While the Receiver General's ongoing risk management process had been focussed on the risks associated with the current central system development, we note that transition-related risks were formally added to the Receiver General's risk issues summary during the latest joint Receiver General-Treasury Board Secretariat risk management workshop held in June 1998. In addition, the Receiver General has various contingency plans in place in the event that systems do not work as planned.

## Systems Renewal: Development and Implementation of New Departmental Systems

**18.68** As mentioned, we found that the FIS implementation effort within departments has generally focussed on implementing new financial systems that will eventually provide financial accounting information for external reporting under FIS. In addition, we found that Year 2000 compliance has been driving the current push to implement these new departmental financial systems. This means that departments still have major challenges ahead in achieving the broader FIS vision outlined in Exhibit 18.1. Once the Year 2000 situation is resolved, we believe that there will be a need for some form of additional incentive to motivate departments to ensure that they implement the necessary components for achieving the full benefits of FIS and that they meet the April 2001 target date for implementation.

Further incentives will be needed to motivate departments to meet the April 2001 target date for FIS implementation.

**18.69** Some departments have already implemented their new systems while others are at various stages of planning, development or implementation. We reviewed the implementation of six departmental financial systems (see **About the Audit**), with a view to determining the lessons learned that could provide guidance to the departments that have yet to implement their new systems. Exhibit 18.7 provides examples of lessons learned identified by the financial system developers themselves.

The implementation of six departmental financial systems provides lessons learned for those departments that have yet to implement new systems.

**18.70** We also identified a number of additional findings that specifically relate to implementation of the departmental financial systems and the significant challenges that affect all the departments. The following paragraphs summarize our

findings on the risks the government faces in implementing the full vision of FIS.

**18.71 Management reporting.** Given that the use of financial information for management decision making is one of the key objectives of FIS, we expected to find that the new financial systems would have management reporting capabilities. However, we found that none of the systems we reviewed had adequate management reporting in place. We noted, though, that each department had plans to meet this requirement in the future.

**18.72 Organizational change.** Departments will undergo significant change if they meet the full vision of FIS. New financial systems, full accrual accounting, and responsibility for detailed financial information will all add a new dimension to the role of departments. The Treasury Board Secretariat has already recognized the importance of managing the significant changes required to achieve the full vision of FIS.

**18.73** However, as previously noted, departments have not yet incorporated in their systems the capability to allow

**Exhibit 18.7**

**Best Practices and Lessons Learned by Departments**

The implementation of a modern financial system is far more complicated than anyone would predict. During our review, departments described to us the best practices and lessons learned that they believed would help other departments that are beginning to implement a new system.

**Examples of Best Practices**

Individual departments used many industry and government best practices, including several we have suggested over the years. These include the use of time reporting for departmental employees, performance measures, risk management, involvement of sponsors, and open communications. For example:

- Foreign Affairs and International Trade Canada put in place time reporting for departmental employees working on the implementation of the new system, and other performance measures.
- The Receiver General, with the active participation of sponsors, instituted a rigorous continuous risk management process. Project managers now know, when they have a problem, how serious it is and what priority it should have.
- Fisheries and Oceans has taken the position that it should move ahead slowly based on the assessment of other departments' success with their systems. This has led to a stable installation at the Department.

**Examples of Lessons Learned**

**Initiation of the Project:**

- It is important to make changes to business processes before automating them.
- Technical infrastructure and team facilities are needed at the start.
- The time needed for cleaning up information in existing systems is generally underestimated.
- Testing is more complex and needs more time than anyone planned.

**Project Management:**

- Project management best practices and rigorous discipline are key to delivery.
- Knowledge transfer from consultants to staff must be planned up front.

**Project Execution:**

- Project office staffing needs have been underestimated especially after initial implementation.
- Information technology experts need to be involved in the implementation.
- Once the plan is set out, stick to it – if major events occur, react quickly with a new plan.
- Be prepared to face high turnover by having backup plans.
- It is important to control changes to requirements rigorously.

departmental line managers to meet the broader FIS vision for management decision making. We found a wide range of management plans for access to basic financial information, from access limited to financial managers to access provided to all managers. Since it is still early in the life of FIS, we would expect the departments to prepare plans for how they intend to meet FIS goals for better financial information for use by managers. We will monitor progress in this area as part of our future audits.

**18.74 Costs.** We found that departments need to do a better job of estimating and tracking resources used to implement new systems and other major projects as a matter of good project management. Since one of the objectives of FIS is better information for management decision making, it would set a good example to "walk the talk" with departmental implementation of FIS. As explained in paragraph 18.49, we recognize that much of the work on FIS also supports other departmental objectives. However, the identification and capture of FIS implementation costs is currently ad hoc and unorganized. We also found that when the financial systems were purchased, there was no calculation in departments of total life cycle costs, including the future costs for maintenance, enhancements and upgrades. We believe that these future costs are significant because they typically represent the largest part of the investment in major systems development.

**18.75 Controls and security.** We found that the plans for security and management control in the financial systems we reviewed were weak, for example, access and document authorization. We are concerned that without appropriate operational controls, there is the risk of lapses in sound financial management. These types of management and systems controls need to be considered before the design is declared complete. They are more difficult to implement after the system is operational. We are also concerned that without appropriate system access controls, particularly for developers, changes could be made that compromise the integrity of the system.

**18.76 Resources.** Implementing these financial systems is extremely resource-intensive. Some departments reported that their biggest concern is the difficulty of obtaining and retaining experienced, skilled resources. Since many departments are looking for the same resources at the same time, they tend to compete with each other and create a temporary scarcity. We expected to see this risk dealt with by the Treasury Board Secretariat and the cluster groups (described in the Appendix). In most instances, however, the government has chosen to rely on private sector consultants who, in trying to meet the demands for services, are themselves still learning about the systems. Some departmental managers found that they must pay close attention to consultants' work to ensure that they are getting full value. This is all the more difficult because departmental staff are still becoming familiar with the system. In addition, one of the lessons learned by departments (see Exhibit 18.7) was ensuring that appropriate knowledge transfer occurs from consultants to departmental staff.

**18.77 Internal audit.** We expected that departmental internal audit groups, where they have the expertise, would play a key role in reviewing progress, reviewing risk assessments, conducting reviews of security and management controls, and establishing requirements for auditability and data integrity. This would help ensure the success of both the implementation of new departmental financial systems and the move to FIS.

**18.78** In one department we found that internal audit played a key role where the auditors were involved with the project team from the beginning. However, we also found that, in most cases, auditors do

not yet have the training and expertise to audit the complex requirements for authorizing and controlling actions that exist in the shared systems.

**18.79 The Treasury Board Secretariat should provide additional guidance to departments on the development of their departmental FIS implementation plans. To ensure that these plans are complete, departments should ensure that they include the following provisions:**

- **management reporting requirements under the FIS environment;**
- **a change management plan showing how management and staff will be reoriented, reorganized and retrained to meet all of the requirements of the new FIS environment, not just the systems renewal component;**
- **periodic determination and reporting of the full life-cycle cost of their FIS implementation;**
- **a plan for security and management controls that would be subject to an external review prior to putting the new systems into production;**
- **a plan to manage the risks associated with the current lack of experienced, expert resources for systems implementation and enhancement; and**
- **the role for, and the training of, departmental internal audit groups in reviewing progress, reviewing risk assessments, conducting reviews of security and management controls, and establishing requirements for auditability and data integrity.**

## Conclusion

**18.80** Exhibit 18.8 provides a scorecard of progress to date in implementation of

Exhibit 18.8

Scorecard of Government Progress to Date Under FIS

| | Planned Under FIS | Progress to Date Under FIS |
|---|---|---|
| **Government-wide financial information** | | |
| • Financial statements that report all assets and liabilities | Yes | In Progress |
| • Monthly financial statements on the same basis as the annual statements | Yes | In Progress |
| • Annual financial statements available soon after the fiscal year end | Yes | Limited progress* |
| • Annual financial statements that are audited | Yes | In place |
| **Departmental financial information** | | |
| Complete, accurate, relevant and timely financial information, for example: | | |
| • to set prices and fees or to recover costs; | Yes | * |
| • to assess stewardship of assets and liabilities; | Yes | * |
| • to assess efficiency and cost effectiveness of operations; | Yes | * |
| • for use in selling or restructuring operating units; and | Yes | * |
| • for lease versus buy decisions. | Yes | * |

* Planned for later implementation

FIS. However, to realize the full benefits of FIS, a number of challenges remain to be addressed.

**18.81** The most significant challenge will be to integrate FIS into day-to-day departmental decision making. The full benefits of FIS will be realized only through the provision of more complete information on the costs of business lines and related components to enable managers to link this information to results achieved when making key decisions.

**18.82** Through changing the basis on which Parliament appropriates funds, the government and Parliament can help ensure that FIS is successfully implemented. But this, by itself, is not enough. Central agencies and departments must also act to help ensure that the government achieves the full vision of FIS. Central agencies can help lay the foundation for success by requiring departments to prepare their Reports on Plans and Priorities as well as their departmental Performance Reports on a full accrual basis, and by obtaining complete departmental "buy-in" to the full vision of FIS. Deputy ministers of departments must then ensure that all the necessary infrastructure is put in place within each of their departments, including appropriate systems and human resources, to fully achieve the objectives of FIS.

**18.83** The FIS Control Framework reasonably establishes the financial accounting and controls required under FIS. However, no guidance has yet been provided on the required integration of FIS into departmental management decision making as envisioned under FIS. In addition, more guidance is required on the accounting and control environment that will be required during the planned three-year transition period during which departments will move from the old Central Accounting System to the new FIS environment.

**18.84** The central systems have been developed in a manner that is consistent with the FIS and Receiver General control frameworks. The lessons learned from the implementation of new departmental financial systems need to be gathered and communicated to those departments that have yet to implement their new systems.

**18.85** Given the large-scale financial systems renewal exercise under way, we believe there is a unique opportunity to put the full vision for FIS in place by the 2001 target implementation date. To achieve this vision, and thus have in place the information required for government today, the challenges faced by the government and summarized in this chapter must be met. In future audits, we will continue to assess the government's progress toward achieving the full benefits of FIS.

**The challenges faced by the government, and summarized in this chapter, must be met if the full vision for FIS is to be achieved.**

***Treasury Board Secretariat's comments:*** *The government agrees that FIS is a key vehicle to enable changes, such as the modernizing of comptrollership, that are important to both governance and management. The chapter describes the main challenges that face the government in implementing FIS and notes that either they are being addressed or plans are in place to address them.*

*We offer the following comments on the three strategic challenges that are highlighted:*

- *Integration of FIS into departmental management: This will take place over a long period of time, as it requires not only an improvement in available information but also a change in culture. The implementation of the comprehensive FIS Training Framework will go a long way toward meeting this challenge.*

- *Moving to accrual-based appropriations: The views of the Office of the Auditor General on this important subject are appreciated. But there are alternatives to be considered and stakeholders, including Parliament, to be*

*consulted before the Treasury Board Secretariat makes a formal proposal to change the basis of appropriations.*

- *Obtaining departmental buy-in: The involvement of senior financial officers (SFOs) from across government in the four oversight committees that governed FIS from November 1995 to March 1998 helped considerably with this challenge.*

*The committees that are being established to oversee the modernizing of comptrollership, including the Modernization Task Force of Deputy Ministers, and the new FIS SFO Steering Committee will continue to engage senior managers in departments and agencies.*



# About the Audit

## Objectives and Criteria

The objectives of the audit were to review and assess the government's overall management of FIS, including:

- whether the FIS and Receiver General control frameworks provide an adequate framework for the new accounting environment by dealing with all significant risks;
- whether the central systems are designed, developed and implemented in a manner consistent with the FIS and Receiver General control frameworks; and
- whether the development and implementation of a selection of departmental financial systems are adequate and could provide lessons learned for those departments that will be implementing their new financial management systems in the future.

Detailed audit criteria were developed and agreed with government officials at the commencement of the audit and, where relevant, are reflected in the body of this chapter.

## Scope

The audit work on the management of FIS overall, the central control frameworks and the development of new central systems was carried out at the Treasury Board Secretariat and at Public Works and Government Services Canada.

The departmental system implementations selected were at Public Works and Government Services Canada, Treasury Board Secretariat/Department of Finance, Correctional Service Canada, Fisheries and Oceans, Transport Canada and Foreign Affairs and International Trade Canada.

## Approach

We interviewed key personnel at the Treasury Board Secretariat, Receiver General/Public Works and Government Services Canada and the selected departments. We also reviewed relevant documentation and examined demonstrations of both prototypes and developed software applications. In addition, we reviewed previously conducted internal audits and other independent reviews.

## Audit Team

Assistant Auditors General: Ronald C. Thompson and Doug Timmins
Principals: Eric Anttila and Andrew Lennox
Directors: Greg Boyd, Guy Dumas, Martin Ruben, Marvin Schwartz and David Willey

Martine Carrier
Peter Taylor

For information, please contact Eric Anttila or Andrew Lennox.

# Appendix — The Historical Background Leading to FIS

## The call for financial management reform is not new

For over 35 years, there has been a common call for improvements in financial management to support government decision making. The 1962 Royal Commission on Government Organization, the 1979 Royal Commission on Financial Management and Accountability, the Auditor General's 1987 Financial Management and Control Study and the government's 1997 Independent Panel on the Modernization of Comptrollership have all recommended the need for financial management reform. Exhibit 18.3 in the chapter describes some of the key recommendations of these reviews.

## Treasury Board approved the FIS initiative in 1989

In July 1989, the Treasury Board formally approved the government's proposal to "develop and implement a new Financial Information Strategy (FIS) for the Government of Canada." As described in the government's background document *A Financial Information Strategy for the 1990s and Beyond,* there was an "urgent need" by the central agencies, primarily the Department of Finance and the Treasury Board Secretariat, for more timely and accessible financial information to assist in the overall management of government.

The government also recognized that the present Central Accounting System, a then 20-year-old computer system, had reached the end of its economic life and needed to be replaced. The government believed that it had a unique window of opportunity to start building a modern information infrastructure that would meet the needs of that time, and last the government through the 1990s and beyond.

The government reviewed two options at that time: a centralized financial information approach (essentially a modernization of the existing Central Accounting System) and a distributed financial information approach (departments providing summary information to a central point). The latter option was chosen as the basis for the FIS proposal because it eliminated the duplication of detailed information at the centre. The focus of the FIS initiative was on the information required by the central agencies to manage government overall. Departments were seen as providers of the summary information required by the central agencies.

## Minister of Finance gives FIS a much-needed push

For six years, little progress was made in implementing FIS, although some effort was made to revitalize the project in 1994. Then, in his February 1995 Budget, the Minister of Finance stated that the government would move to full accrual accounting. While no timetable for full implementation was given, the announcement placed renewed pressure on the government to ensure that the appropriate systems, people and infrastructure would be in place to support the move to full accrual accounting.

In November 1995, the Treasury Board endorsed FIS as a "government priority" and approved the updated FIS objectives, scope, and implementation approach. Under the renewed strategy, responsibility for accounting was to be fully decentralized to the departments, which would now be accountable for the quality and timeliness of the financial information they provided to the centre for government-wide reporting purposes. Departments would need to upgrade their financial management systems so that they could maintain departmental general ledgers and, ultimately, produce auditable annual departmental financial statements.

To help departments upgrade their systems in a cost-effective manner, the government initiated the Shared Systems Initiative for financial management systems. Departments were to select one of seven approved financial systems and, through the use of "cluster groups", would share the costs of development of core system requirements, training and related maintenance.

In addition, the scope of FIS was broadened from its initial focus on the government-wide information needs of central agencies. FIS was now seen as providing the basis for improvements in management accounting and

accountability in departments and agencies, as well as improvements in government-wide financial reporting. The government's current vision, mission and tactics for the implementation of FIS are described in Exhibit 18.1 of the chapter.

The new central systems were planned to be completed by April 1998. This deadline has since changed to April 1999. Once departments become FIS-ready, they will then move to the new FIS environment in one of three annual "waves" starting in April 1999. Full implementation is now scheduled for April 2001. The five-year implementation costs for the Receiver General and Treasury Board Secretariat, covering the 1995–2000 period of the original plan, were initially estimated to be $23 million. This estimate did not include the cost of departmental implementation of FIS.

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